LIBRARY
SUPREME COURT, U.S.

APPENDIX

FILED
MAY 20 1971
E. ROBERT SEAVER, CLERK

70-79

In the Supreme Court of the United States

OCTOBER TERM, 1970.

No. 1022

RELIANCE ELECTRIC COMPANY,
Petitioner,

v.

EMERSON ELECTRIC COMPANY,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

Petition for Writ of Certiorari
Filed February 9, 1971.
Certiorari Granted April 5, 1971.

TABLE OF CONTENTS.

Relevant Docket Entries in the District Court, Eastern District of Missouri, Eastern Division 1

Relevant Docket Entries in the U. S. Court of Appeals, Eighth Circuit 2

Complaint for Declaratory Judgment (Feb. 29, 1968) 3

Exhibit A—Letter dated December 28, 1967, from Abraham L. Pomerantz to Board of Directors of Reliance 7

Exhibit B—Letter dated February 13, 1968, from Jones, Day, Cockley & Reavis to Emerson 8

Answer and Counterclaim (Mar. 21, 1968) 10

Reply to Counterclaim (Mar. 28, 1968) 14

Stipulation (Feb. 3, 1969) 15

Stipulation Exhibits.

1.1. Offer to Purchase by Emerson of Dodge Common Stock dated May 22, 1967 19

1.2. Statement of Value 23

1.3. Letter of Transmittal 25

1.4. Instructions for Tender of Shares in Acceptance of Offer 29

1.5. Letter to Securities Dealers 31

2.1. Letter to W. R. Persons from Bryan, Cave, McPheeters & McRoberts dated June 26, 1967 33

2.2. Letter to W. R. Persons from Bryan, Cave, McPheeters & McRoberts dated July 7, 1967 39

3.1. Letter to Goldman, Sachs & Company from G. W. Mellicker dated August 29, 1967 41

4.1. Purchase Agreement ---- 43
4.2. Letter to Dodge from Emerson dated September 11, 1967 ---- 46
4.3. Opinion of Counsel dated September 11, 1967 ---- 47
4.4. Letter to Emerson from Reliance and Dodge dated September 11, 1967 ---- 48
4.5. Letter to Dodge from Bryan, Cave, McPheeters & McRoberts dated September 13, 1967 ---- 49
4.6. Letter to Emerson from Hopkins, Sutter, Owen, Mulroy, Wentz & Davis dated September 13, 1967 ---- 51

Transcript of Proceedings (Feb. 3, 1969) ---- 52
Appearances ---- 52
Colloquy ---- 52
Opening Statement in Behalf of Plaintiff ---- 53
Opening Statement in Behalf of Defendant ---- 55
Plaintiff's Evidence:
W. R. Persons, Direct Examination ---- 56
Colloquy ---- 67

Plaintiff's Exhibits.

1. Telegram 3-22-67 ---- 69
3. Offer to Purchase 5/24/67 ---- 70
4. Extension of Offer to Purchase 6/12/67 ---- 72
5. St. Louis Post-Dispatch Clip 5/23/67 ---- 74
6. Wall Street Journal Clip 5/23/67 ---- 75
7. Dodge Letter to Shareholders 5/24/67 ---- 76
8. MacLean Letter to Dodge Shareholders 5/25/67 ---- 78

9. St. Louis Post-Dispatch Clip 5/26/67 80
10. Verified Complaint and Order, Dodge Manufacturing Corporation v. Emerson Electric Co., No. 4023 (U.S.D.C., N.D. Ind.) 81
11. MacLean Letter to Dodge Shareholders 5/27/67 98
12. MacLean Letter to Dodge Shareholders 5/29/67 99
14. MacLean Letter to Dodge Shareholders 6/12/67 101
15. Letter to MacLean from Persons 6/17/67 102
16. Wall Street Journal Clip 6/19/67 104
17. Letter to Persons from MacLean 6/20/67 107
18. Letter to MacLean from Persons 6/21/67 108
19. Letter to Persons from McLean 6/22/67 110
20. Complaint and Order, State ex rel. Emerson Electric Co. v. Dodge Manufacturing Corporation, No. D-3655 (St. Joseph Superior Court) 113
21. Letter to MacLean from Persons 6/29/67 122
23. Letter to Persons from MacLean 6/30/67 124
24. Emerson Letter to Dodge Shareholders 7/13/67 125
25. Complaint, Emerson Electric Co. v. Dodge Manufacturing Corporation, No. 4050 (U.S.D.C., N.D. Ind.) 127
26. MacLean Letter to Dodge Shareholders 7/24/67 130
27. Emerson Proxy Statement and Letter to Dodge Shareholders 7/31/67 132
28. MacLean Letter to Dodge Shareholders 8/4/67 146

29. Emerson Letter to Dodge Shareholders 8/4/67 ---------- 149
30. Emerson Letter to Dodge Shareholders 8/10/67 ---------- 151
31. Emerson Letter to Dodge Shareholders 8/16/67 ---------- 153
33. Reliance Proxy Statement re Toledo Scale Corporation ---------- 155

Memorandum Opinion of the District Court (Sept. 18, 1969) ---------- 157
Interlocutory Declaratory Judgment of the District Court (Oct. 9, 1969) ---------- 165
Petition for Permission to Take an Appeal (Oct. 20, 1969) ---------- 167
Order Granting Petition for Leave to Appeal (Nov. 6, 1969) ---------- 169
Opinion of the Court of Appeals (Nov. 12, 1970) -- 170
Judgment of the Court of Appeals (Nov. 12, 1970) 183

Civil Action No. 68 C 87 (3).

In the United States District Court

FOR THE EASTERN DISTRICT OF MISSOURI,
EASTERN DIVISION.

EMERSON ELECTRIC CO.,
Plaintiff,

v.

RELIANCE ELECTRIC COMPANY,
Defendant.

RELEVANT DOCKET ENTRIES.

1968

Feb. 29. Complaint filed and summons issued.
Mar. 21. Answer and counterclaim filed.
Mar. 28. Plff's reply to counterclaim filed.

1969

Feb. 3. Final hearing of cause before the Court on issue of liability only commenced and concluded. Stipulation filed by the parties.

Sept. 18. Memorandum Opinion filed holding that Emerson Electric Company is liable to Reliance Electric Company as the successor in interest to Dodge Manufacturing Corp., for the net profits realized by Emerson from the sale of all its 152,282 shares of Dodge stock, and directing counsel for Reliance submit a form of interlocutory declaratory judgment in accordance therewith; said Memorandum Opinion constituting the Court's findings of fact and conclusions of law on the issue of liability.

Oct. 9. Interlocutory declaratory judgment, as approved by the parties, filed and entered decreeing Emerson Electric Company is liable to deft Reliance Electric Company for the net profits realized by plff from the sales of 152,282 shares of stock of Dodge Manufacturing Company on August 28 and September 13, 1967; and further ordering that this matter be certified under Title 28 USCA, Sec. 1292(b) and that all proceedings in this cause be stayed pending the final action of the USCA for the 8th Circuit.

No. 20014.

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT.

EMERSON ELECTRIC CO.,
Appellant,

vs.

RELIANCE ELECTRIC COMPANY,
Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MISSOURI.

RELEVANT DOCKET ENTRIES.

1969

Oct. 20. Petition for permission to take an appeal from an Interlocutory Order pursuant to 28 U.S.C., Sec. 1292(b).

Oct. 30. Answer in opposition to Petition for permission to take appeal.

Nov. 6. Order: Petition for leave to take interlocutory appeal granted.

1970

Sept. 15. Argued and submitted to Judges Gibson, Lay and Hunter. Arg. com. by R. H. McRoberts for applnt; cont. by Thomas P. Mulligan for appellee.

Nov. 12. Opinion by Judge Hunter.

Nov. 12. Judgment: Cause remanded to Dist. Ct. with directions to proceed in accordance with views expressed in opinion.

Dec. 11. Mandate issued.

1971

Feb. 11. Notice of filing of Petition for Cert. in Sup. Court.

IN THE UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF MISSOURI, EASTERN DIVISION.

(Title omitted in printing.)

COMPLAINT FOR DECLARATORY JUDGMENT.

(Filed February 29, 1968.)

Plaintiff, for its complaint herein, alleges as follows:

1. Plaintiff is a Missouri corporation and has its principal place of business in Missouri.

2. Defendant is an Ohio corporation and has its principal place of business in Ohio but is doing business in Missouri and has an office in the County of St. Louis, Missouri.

3. The jurisdiction of this Court rests on diversity of citizenship and amount.

4. The amount in controversy, exclusive of interest and costs, exceeds $10,000. This is an action for declaratory judgment as authorized by Section 2201, Title 28 of the United States Code (28 U. S. C. A. § 2201) and is brought because there is an actual controversy now existing between the parties hereto.

5. Prior to June 16, 1967, plaintiff owned no shares of common stock of Dodge Manufacturing Corporation, an Indiana corporation ("Dodge"). On or about June 16, 1967 plaintiff purchased 152,282 shares of the outstanding common stock of Dodge, pursuant to an invitation for tenders at a price of $63 per share, with a commission of 90¢ per share payable to brokers. These shares constituted more than 10 per cent of the then outstanding shares of common stock of Dodge. At no time thereafter did plaintiff acquire any additional shares of such stock of Dodge.

6. On or about August 28, 1967, Emerson sold 37,000 of such shares on the New York Stock Exchange at a gross price of $68 per share.

7. On or about September 13, 1967 plaintiff sold the 115,282 shares of such common stock then remaining in its

hands to Dodge at a gross price of $69 per share. At that time, plaintiff was not the owner of 10 per cent or more of the then outstanding shares of common stock of Dodge.

8. On or about September 30, 1967, Dodge merged into defendant Reliance Electric Company, an Ohio corporation ("Reliance"), and the corporate existence of Dodge came to an end.

9. Plaintiff realized a net profit on the sale of the 37,000 shares of such common stock, described in paragraph 7 hereinabove, of more than $10,000.

10. Plaintiff realized a net profit on the sale of the 115,282 shares of such common stock, described in paragraph 7 hereinabove, of more than $10,000.

11. By letter dated December 28, 1967 Mr. Abraham L. Pomerantz wrote to the Board of Directors of Reliance demanding that Reliance take appropriate action against plaintiff to recover the profit alleged to have been made on a sale of 152,000 shares of the common stock of Dodge back to Dodge, and advising that if Reliance should not act he would bring an action on Reliance's behalf against Emerson, and would not sue Reliance's directors. A copy of said letter is attached hereto, marked Exhibit "A," and incorporated herein.

12. By letter dated February 13, 1968, and received by plaintiff on or about February 16, 1968, counsel for Reliance made a demand upon plaintiff that the full amount of the plaintiff's profits on the sale described in paragraph 6 hereinabove be paid to Reliance under the provisions of Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A. Section 378aa. In said letter, counsel for Reliance state that, in their opinion, the plaintiff's profits on the sale described in paragraph 7 hereinabove are not recoverable by Reliance inasmuch as plaintiff was not at the time of such sale the owner of 10 per cent or more of the outstanding stock of Dodge. However, in said letter counsel state that counsel (a) reserve the right to reconsider this opinion "if developments in the law or other factors should cause a change in our present view" and (b) "spe-

cifically reserve the right to assert a claim with respect to profits made on such sale if litigation should develop in connection with this matter." A copy of said letter is attached hereto, marked Exhibit "B," and incorporated herein.

13. Section 16(b) of the Securities Exchange Act of 1934 provides, in part:

> "* * * any profit realized by [the beneficial owner of more than 10% of any class of equity security of an issuer which is registered on a national securities exchange] from any purchase and sale or any sale and purchase of any equity security of such issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer * * *"

14. Plaintiff is advised by its counsel that in their opinion, based upon cases from other judicial Circuits, the provisions of Section 16(b) should not apply to the sale described in paragraph 6 hereinabove even though at the time of such sale plaintiff was the owner of more than 10 per cent of the then outstanding shares of common stock of Dodge. However, plaintiff is further advised by its counsel, and believes, that there has been no final judicial determination in this judicial Circuit of the applicability of Section 16(b) to the profits realized on the sale of stock whose acquisition initially caused the seller to become the holder of more than 10 per cent of such outstanding shares. Accordingly, plaintiff is advised by its counsel, and believes, that in view of the demands set forth in the originals of Exhibits "A" and "B" hereto plaintiff requires the determination of this Court with respect to its liability to Reliance, if any, for the amount of such profits.

15. Plaintiff is also advised by its counsel that in their opinion the provisions of Section 16(b) of the Securities Exchange Act of 1934 do not apply to the sale described in paragraph 7 hereinabove for the reason that at the time of such sale plaintiff was not the owner of 10 per cent or more of the then outstanding shares of common stock of Dodge. However, plaintiff is further advised by its coun-

sel, that by reason of the potential claims suggested in, and threatened by, the originals of Exhibits "A" and "B" hereto for the amount of the profits of such sale plaintiff requires the determination of this Court with respect to its liability to Reliance, if any, for the amount of such profits.

16. By reason of the facts hereinabove set forth, plaintiff seeks the advice, instructions, directions and declaratory judgment of this Court with respect to its liability to Reliance, if any, for the amount of profits from the sales described in paragraphs 6 and 7 of the within Complaint.

WHEREFORE, plaintiff prays

(1) that by its decree herein the Court determine and declare the rights of the parties and the liability, if any, of plaintiff to Reliance for the amounts of the profits on either or both of the transactions described hereinabove;

(2) that the Court give such further relief by way of declarations of the rights of the parties or otherwise as the Court may deem just and proper; and

(3) that the Court allow plaintiff its costs herein.

R. H. MCROBERTS,
R. H. MCROBERTS, JR.,
Attorneys for Plaintiff,
1600 Boatmen's Bank Bldg.,
St. Louis, Missouri 63102.

BRYAN, CAVE, MCPHEETERS & MCROBERTS,
Of Counsel.

EXHIBIT "A."

(Letterhead of Pomerantz Levy Haudek & Block,
295 Madison Avenue, New York, N. Y. 10017)

December 28, 1967

The Board of Directors
Reliance Electric & Engineering Company
24701 Euclid Avenue
Cleveland, Ohio

Dear Sirs:

We are writing to you on behalf of our client, Mr. Harry Lewis, who has been a shareholder of Reliance Electric & Engineering Co. for many years.

According to our information, during May and June, 1967, Emerson Electric Co. purchased 152,000 shares of the common stock of Dodge Manufacturing Corporation at a price of $63 per share pursuant to a tender offer. Emerson sold all of these shares back to Dodge in August and September of 1967 (within six months of their purchase) at a time when the market price of the Dodge shares on the New York Stock Exchange was approximately $73 per share. Since Emerson owned more than 10% of Dodge's outstanding common stock, the profit that Emerson made on its purchase and sale of the Dodge stock inures to Dodge pursuant to Section 16(b) of the Securities Exchange Act of 1934. Since Dodge has been merged into Reliance, Reliance now has the obligation of recovering from Emerson this short-swing profit.

We are writing this letter, pursuant to Section 16 (b), to demand that Reliance take appropriate action against Emerson to recover the aforesaid profit. If Reliance does not act, we have been instructed by our client to institute proceedings on Reliance's behalf.

We trust that you will advise us promptly as to whether Reliance intends to act. If we are wrong in our understanding of the facts, we would appreciate it if you would so inform us because we have no wish to involve Reliance in a litigation that is not meritorious. I might add that if we do go forward, we would bring our action

on Reliance's behalf against Emerson only and would not sue Reliance's directors.

Yours truly,

/s/ A. L. POMERANTZ
Abraham L. Pomerantz

ALP:cer

EXHIBIT "B."

(Letterhead of Jones, Day, Cockley & Reavis,
1750 Union Commerce Building, Cleveland, Ohio 44115)

February 13, 1968

Emerson Electric Company
8100 Florissant Avenue
St. Louis, Missouri 63136

Gentlemen: Attention: Mr. McRoberts

On behalf of our client, Reliance Electric, we are writing to inform you that Reliance has authorized and directed us to take all appropriate steps to recover any profits which may have been made by Emerson Electric Company in connection with its purchase and sale of certain shares of Common Stock of Dodge Manufacturing Corporation.

On the basis of information available to us, we understand the relevant facts are that on or about June 16, 1967 Emerson purchased 152,282 shares of common Stock of Dodge pursuant to an invitation for tenders at a price of $63, with a commission of 90¢ payable to brokers. Those shares constituted more than 10% of the then outstanding shares of Common Stock of Dodge. On or about August 28, Emerson sold 37,000 of such shares on the New York Stock Exchange at a price of $68 per share. We believe that the profits made on such sale by Emerson are legally recoverable by Reliance, as successor by

merger to Dodge, under the provisions of Section 16 of the Securities Exchange Act of 1934, and we have advised Reliance that it should take all reasonable action to recover such profits for the Company.

In view of the foregoing, we hereby demand, on behalf of our client, that the full amount of such profits be paid to Reliance. The exact amount of such recovery will depend in part upon the costs, allowable under Section 16, which Emerson is able to establish were directly incurred by it in connection with the purchase and sale of such shares. The burden of establishing such costs rests with Emerson and until that is done we have no alternative but to demand the full amount of such profits.

On or about September 13, 1967 Emerson sold 115,282 shares of Dodge stock to Dodge at a price of $69 per share. We have previously stated that, in our opinion, the profits which Emerson may have made on such sale are not recoverable by Reliance, since Emerson was not then the owner of 10% or more of the outstanding stock of Dodge. Nothing has developed to change that opinion. Accordingly, our demand does not relate to the profits realized by Emerson on such sale. This statement should in no sense be construed as a waiver by Reliance of whatever rights it may have to recover any such profits and naturally we reserve the right to reconsider this matter if developments in the law or other factors should cause a change in our present view. We specifically reserve the right to assert a claim with respect to the profits made on such sale if litigation should develop in connection with this matter.

We would appreciate your advising us promptly of the position you intend to take in response to the demands outlined in this letter. Your reply will, of course, affect the decision as to what further action will be taken by Reliance.

Very truly yours,

/s/ Jones, Day, Cockley & Reavis
Jones, Day, Cockley & Reavis

IN THE UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF MISSOURI, EASTERN DIVISION.

(Title omitted in printing.)

ANSWER AND COUNTERCLAIM.

(Filed March 21, 1968.)

ANSWER.

For its answer to plaintiff's complaint, defendant (whose correct corporate name is The Reliance Electric and Engineering Company) admits and denies as follows:

1. Admits the allegations of paragraph 1.

2. Admits the allegations of paragraph 2.

3. Denies the allegations of paragraph 3, and avers that the jurisdiction of this Court rests on Section 27 of the Securities Exchange Act of 1934 (15 U. S. C. § 78aa).

4. Admits the allegations of paragraph 4.

5. Admits that on or about June 16, 1967 plaintiff purchased 152,282 shares of the outstanding common stock of Dodge Manufacturing Corporation, an Indiana corporation ("Dodge"), pursuant to an invitation for tenders at a price of $63.00 per share, which shares constituted more than 10% of the then outstanding shares of common stock of Dodge. Except as admitted defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph 5.

6. Admits the allegations of paragraph 6, and avers that said sale of August 28, 1967 constituted one transaction with the sale of September 13, 1967 referred to in paragraph 7.

7. Admits that on or about September 13, 1967, plaintiff sold 115,282 shares of common stock of Dodge to Dodge at a price of $69.00 per share; avers that said sale of September 13, 1967 constituted one transaction with the sale of August 28, 1967, referred to in paragraph 6;

and, except as admitted, denies the allegations of paragraph 7.

8. Admits the allegations of paragraph 8.

9. and 10. Admits the allegations of paragraphs 9 and 10, and avers that the profit realized by plaintiff on the transaction of sale of 152,282 shares of common stock of Dodge which took place on August 28, 1967 and September 13, 1967 amounted to $876,692, plus a dividend of 45¢ a share received by plaintiff in respect of such shares, less such expenses as may be allowed by law.

11. Admits, as to paragraph 11, that defendant received a letter dated December 28, 1967, copy of which is attached to the complaint as Exhibit A.

12. Admits, as to paragraph 12, that counsel for defendant wrote and plaintiff received a letter dated February 13, 1968, copy of which is attached to the complaint as Exhibit B.

13. Admits the allegations of paragraph 13.

14. and 15. Defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations of paragraphs 14 and 15 except that defendant avers that the provisions of said Section 16(b) should and do apply to the transaction described in paragraphs 6 and 7 of plaintiff's complaint.

16. Defendant joins in plaintiff's request for a declaration by this Court as to the liability of plaintiff to defendant and for a determination as to the amount of profit recoverable by defendant on account of said transaction of sale.

Wherefore, having fully answered, defendant prays:

(1) that the Court declare the rights of the parties and the liability of plaintiff to defendant for the amount of the profit on the transaction described herein;

(2) that the Court grant such further relief against plaintiff as may be necessary or proper; and

(3) that the Court allow defendant its costs herein.

COUNTERCLAIM.

For its counterclaim herein defendant (whose correct corporate name is The Reliance Electric and Engineering Company) alleges as follows:

1. Jurisdiction of this Court is based upon Section 27 of the Securities Exchange Act of 1934 (15 U. S. C. § 78aa).

2. On or about June 16, 1967 plaintiff purchased 152,282 shares of the outstanding common stock of Dodge Manufacturing Corporation, an Indiana corporation ("Dodge") at a price of $63.00 per share, which shares constituted more than 10% of the outstanding shares of common stock of Dodge. The outstanding shares of common stock of Dodge were then listed on the New York Stock Exchange.

3. On or about August 15, 1967 Dodge paid a dividend of 45¢ a share on its common stock to holders of record as of July 27, 1967, including plaintiff.

4. Plaintiff sold 152,282 shares of common stock of Dodge in a transaction which took place on or about August 28 and September 13, 1967, at a price of $68.00 per share as to 37,000 shares and $69.00 per share as to 115,282 shares.

5. On or about September 29, 1967, Dodge, the issuer of such shares, was merged into defendant, and defendant succeeded to the rights and powers of Dodge pursuant to law.

6. The profit realized by plaintiff from the transaction referred to in paragraph 4 above is recoverable by defendant pursuant to the provisions of Section 16(b) of the Securities Act of 1934 (15 U. S. C. § 78p (b)).

7. Plaintiff realized a profit on the purchase and sale of Dodge shares hereinabove described in the amount of $876,692.00, plus said dividend of 45¢ per share in the total amount of $68,526.90, less such expenses as may be allowed by law.

Wherefore, defendant prays for judgment against plaintiff on its counterclaim in the amount of $945,218.90, less such of plaintiff's expenses as may be allowed by law, together with interest and defendant's costs herein.

KENNETH TEASDALE
Railway Exchange Building
611 Olive Street
St. Louis, Missouri 63101

THOMAS P. MULLIGAN
1750 Union Commerce Building
Cleveland, Ohio 44115
Attorneys for Defendant

Of Counsel:

ARMSTRONG, TEASDALE, KRAMER & VAUGHAN
Railway Exchange Building
611 Olive Street
St. Louis, Missouri 63101

JONES, DAY, COCKLEY & REAVIS
1750 Union Commerce Building
Cleveland, Ohio 44115

IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MISSOURI, EASTERN DIVISION.

(Title omitted in printing.)

REPLY TO COUNTERCLAIM.

(Filed March 28, 1968.)

Comes now plaintiff in the above entitled cause (whose correct corporate name is "Emerson Electric Co."), and for reply to defendant's counterclaim filed herein, states as follows:

1. It admits the allegations in Paragraph 1 of said counterclaim.

2. It admits the allegations in Paragraph 2 of said counterclaim.

3. It admits the allegations in Paragraph 3 of said counterclaim.

4. It admits that it sold a total of 152,282 shares of common stock of Dodge Manufacturing Corporation, an Indiana corporation (Dodge), but denies that said shares were sold in a transaction, and states, instead, that said shares were sold in two separate and distinct transactions, one of 37,000 shares on or about August 28, 1967, at a price of $68.00 per share, and one on or about September 13, 1967, of 115,282 shares at a price of $69.00 per share.

5. It admits the allegations in Paragraph 5 of said counterclaim.

6. It denies the allegations in Paragraph 6 of said counterclaim.

7. It admits that it realized a profit on the purchase and each of the separate sales of common stock of Dodge, as aforesaid, but denies each and every other allegation in said Paragraph 7 contained.

WHEREFORE, plaintiff prays for judgment in its favor on said counterclaim, dismissing the same at defendant's costs.

R. H. MCROBERTS
R. H. MCROBERTS, JR.
Attorneys for Plaintiff

BRYAN, CAVE, MCPHEETERS & MCROBERTS
Of Counsel

(Certificate of Service omitted in printing.)

IN THE UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF MISSOURI, EASTERN DIVISION.

(Title omitted in printing.)

STIPULATION.

(Filed February 3, 1969.)

Now come the parties hereto, and stipulate as follows:

PURCHASE OF DODGE SHARES.

1. Prior to June 16, 1967, plaintiff Emerson Electric Company, a Missouri corporation ("Emerson"), owned no shares of common stock of Dodge Manufacturing Corporation, an Indiana Corporation ("Dodge").

2. On or about May 22, 1967, Emerson made an offer to purchase common stock of Dodge. Attached hereto as Exhibit 1.1 is the offer of Emerson to the holders of common stock of Dodge dated May 22, 1967; attached hereto as Exhibit 1.2 is a Statement of Value of G. H. Walker & Co. dated May 22, 1967; attached hereto as Exhibit 1.3 is the form of Letter of Transmittal provided by Emerson for use in connection with the tender offer; attached hereto as Exhibit 1.4 is a copy of Instructions for Tender of Shares in Acceptance of Offer, provided by Emerson; and attached hereto as Exhibit 1.5 is a letter of G. H. Walker & Co. and Scherck, Stein & Franc, Inc. to securities dealers dated May 22, 1967.

3. On or about June 2, 1967, Emerson extended the time of termination of the tender offer to 5:00 p.m. Chicago time June 16, 1967.

4. At 5:00 p. m., June 16, 1967, Emerson elected to purchase all of the shares tendered at that time, and accordingly did then purchase 152,282 shares of common stock of Dodge.

DISPOSITION BY EMERSON OF DODGE STOCK.

5. On or about June 26, 1967, Bryan, Cave, McPheeters & McRoberts, general counsel for Emerson,

sent to Mr. W. R. Persons, Chairman of the Board of Directors of Emerson, a letter under date of June 26, 1967, a copy of which is attached hereto as Exhibit 2.1.

6. On or about July 7, 1967, Bryan, Cave, McPheeters & McRoberts sent a letter to Mr. Persons under date of July 7, 1967, a copy of which is attached hereto as Exhibit 2.2.

SALE OF 37,000 SHARES.

7. After the Dodge shareholders meeting on August 22, 1967, and several days prior to August 28, 1967, by telephone conversations, Mr. W. L. Davis, President of Emerson, discussed with Mr. L. J. Tenanbaum of Goldman, Sachs & Co., investment bankers ("Goldman, Sachs"), the sale by Emerson and purchase by Goldman, Sachs of 37,000 shares of common stock of Dodge then held by Emerson. Prior to such conversations Emerson had neither made an offer to sell Dodge shares nor received a formal offer to buy Dodge shares.

8. On August 28, 1967, by telephone conversation between Mr. Davis and Mr. Tenanbaum, Emerson agreed to sell and Goldman, Sachs agreed to buy 37,000 shares of common stock of Dodge. Delivery of the shares so sold was made by Mr. G. W. Mellicker, Treasurer of Emerson, to the St. Louis office of Goldman, Sachs on August 29, 1967; a copy of Mr. Mellicker's letter to such office dated August 29, 1967 is attached hereto as Exhibit 3.1.

9. Payment was made by Goldman, Sachs to Emerson's account at Marine Midland Grace Trust Co. of New York on September 1, 1967 in Federal Reserve Funds.

SALE OF 115,282 SHARES.

10. On August 29, 1967, by telephone conversation placed by Mr. N. P. Rose, of Jones, Day, Cockley & Reavis, counsel for Reliance, to Mr. R. H. McRoberts, of Bryan, Cave, McPheeters and McRoberts, counsel for Emerson, Reliance, on behalf of Dodge, initiated discussion with respect to the purchase of the remaining 115,282 shares

of common stock of Dodge from Emerson. Prior to such time Emerson had not offered to sell any of such 115,282 shares.

11. On September 5, 1967, by telephone conversation placed by Mr. McRoberts to Mr. Rose, Emerson agreed to sell and Dodge agreed to purchase the 115,282 shares of common stock of Dodge held by Emerson, subject to the negotiation of a definitive agreement of sale.

12. Thereafter, negotiations toward such an agreement ensued, and on September 11, 1967, a Purchase Agreement was entered into between Dodge and Emerson, a copy of which is set forth in Exhibit 4.1 hereto. At the time of the execution of the Purchase Agreement between Dodge and Emerson, there were delivered by Emerson to Dodge a letter of its President, W. L. Davis, dated September 11, 1967, a copy of which is set forth as Exhibit 4.2 hereto, and an opinion of counsel dated September 11, 1967, a copy of which is set forth as Exhibit 4.3 hereto. At such time there was delivered by counsel for Dodge and counsel for Reliance to Emerson a letter relating to intentions to assert claims under Section 16(b) dated September 11, 1967, a copy of which is set forth as Exhibit 4.4 hereto.

13. The closing under the aforesaid Purchase Agreement took place according to its terms on September 13, 1967, at which closing opinions of counsel for Emerson and counsel for Dodge, set forth as Exhibits 4.5 and 4.6 hereto respectively, were exchanged.

OUTSTANDING SHARES OF DODGE.

14. At the pertinent times, the number of outstanding and treasury shares of Dodge were as follows:

	Shares of Common Stock of Dodge		
Date	Outstanding	Held in Treasury	Total
June 16, 1967	1,151,712	732	1,152,444
August 11, 1967 through September 24, 1967	1,157,437	732	1,158,169

PROFIT.

15. Emerson realized profits from the purchase and sales of 37,000 shares and 115,282 shares of Dodge, respectively.

JURISDICTION.

16. On September 29, 1967, Dodge merged into defendant The Reliance Electric & Engineering Company.

17. At all times between May 1, 1967 and September 29, 1967, the common stock of Dodge was registered pursuant to Section 12 of the Securities Exchange Act of 1934.

Respectfully submitted,

R. H. MCROBERTS,
THOMAS C. WALSH,
Attorneys for Plaintiff.

Of Counsel:

BRYAN, CAVE, MCPHEETERS & MCROBERTS

KENNETH TEASDALE,
THOMAS P. MULLIGAN,
Attorneys for Defendant.

Of Counsel:

ARMSTRONG, TEASDALE, KRAMER & VAUGHAN,
JONES, DAY, COCKLEY & REAVIS.

STIPULATION EXHIBIT 1.1.

EMERSON ELECTRIC CO.
8100 Florissant Avenue
St. Louis, Missouri 63136

Offer to Purchase 550,000 Shares of Common Stock
of
Dodge Manufacturing Corporation
at $63 Per Share

May 22, 1967

To the Holders of Common Stock of
Dodge Manufacturing Corporation

Emerson Electric Co., a Missouri corporation (herein called the "Purchaser"), hereby invites tenders of 550,000 shares of Common Stock of Dodge Manufacturing Corporation, an Indiana corporation (the "Corporation"), for purchase by the Purchaser at $63 per share net to tendering shareholders, payable in cash, all upon and subject to the terms and conditions set forth in this Offer Letter and in the Letter of Transmittal which is enclosed herewith. The Purchaser will pay transfer taxes with respect to such purchases and will also pay a commission to soliciting dealers.

This offer terminates at 5:00 P. M., Chicago time, on June 2, 1967 except that the Purchaser may make one or more extensions of the period of time this offer shall remain open, provided that the Purchaser may sooner terminate any such extension at its sole discretion. Public notice of any extension of this offer or any early termination of such extension will be given.

If the Corporation should, subsequent to the commencement of this offer, declare any dividend or distribution payable to stockholders, the gross amount thereof shall be remitted by the tendering shareholder to the Co-Depositary for the account of the Purchaser; pending assurance of such remittance, the Purchaser may deduct from the purchase price the amount or value of any such dividend or distribution.

The Purchaser will purchase all shares up to 550,000 shares tendered pursuant to this offer before this offer expires, provided at least 460,000 shares are tendered. If less than 460,000 shares are tendered, the Purchaser shall not be obligated to purchase any shares but may elect to purchase all or a portion of the shares tendered. If more than 550,000 shares are tendered, the Purchaser shall not be obligated to purchase the excess shares but may elect to purchase all or a portion of the excess shares tendered. If less than all shares tendered up to June 2, 1967 are purchased, they will be purchased on a pro rata basis with appropriate adjustments to avoid fractional shares. If the offer is extended, and less than all shares tendered during the extended period are purchased, such shares will be purchased in the order in which they are received by the Co-Depositaries. The stock certificates representing shares tendered which are not accepted will be returned without expense to the tendering shareholders. Payment for all shares purchased pursuant to the offer will be made as soon as practicable after the expiration of the tender offer.

A form of Letter of Transmittal to be used in accepting this offer is enclosed. All tenders are irrevocable until the shares are purchased or returned, regardless of whether the offer is extended as herein provided. *To be eligible for consideration, all tenders must be received by a Co-Depositary before the expiration of this offer.* If you wish to accept the offer, you should either:

(1) send your stock certificate(s) in proper form for transfer and the enclosed Letter of Transmittal properly filled out to one of the following Co-Depositaries: First National Bank of Chicago, 38 South Dearborn Street, Chicago, Illinois 60690; Marine Midland Grace Trust Co. of New York, 140 Broadway, New York, New York 10015; or St. Louis Union Trust Co., 510 Locust Street, St. Louis, Missouri 63101; or

(2) request your broker or bank to effect the transaction for you.

In the event that you elect to send in your Letter of Transmittal and certificate(s) directly, the use of insured registered mail, return receipt requested, is recommended as a precaution against the loss of stock certificates, the risk of which remains on you until the certificates are received by the Co-Depositary. If you do not live near any Co-Depositary the use of air mail is also recommended. All questions as to the validity, form, eligibility (including time of receipt) and acceptability of any tender of shares will be determined by the recipient Co-Depositary in its sole discretion.

If it should be impossible to deposit stock certificates immediately, tenders may be accepted if the Letters of Transmittal received by a Co-Depositary prior to the expiration of this offer are executed with proper signatures and contain a guarantee by a member firm of the New York or American Stock Exchange or a commercial bank or trust company having an office or correspondent in the cities of Chicago or New York that certificates for the shares being tendered will be deposited within 8 business days after dispatch of notice by the recipient Co-Depositary to such member, bank or trust company that your tender has been accepted.

The high and low prices of the Corporation's Common Stock on the Midwest Stock Exchange and the New York Stock Exchange for the period 1964-1966, as reported by the National Quotation Bureau, Incorporated, are as follows:

Period	High	Low
1964	29⅞	24¾
1965	36⅞	26
1966	41	31⅝

The high and low prices of the Corporation's Common Stock for 1967 through May 19, 1967, as reported by The Wall Street Journal, were 56¾ and 38¼, respectively. The closing sale on the New York Stock Exchange on Friday, May 19, 1967, the last trading day prior to this offer, was 44¾.

A fee of 90¢ per share purchased in accordance with the terms of this offer will be paid to any member of a national securities exchange or of the National Association of Securities Dealers, Inc. (or any foreign dealer not eligible for membership in such Association who has agreed to conform to the Rules of Fair Practice of such Association) who solicits tenders and whose name appears in the appropriate space provided in the Letter of Transmittal accompanying a tender. No dealer is required to charge his principal an additional commission.

If prior to the purchase of any of the tendered shares by the Purchaser in accordance with this offer there is, in the opinion of the Purchaser, any significant increase in the aggregate number of outstanding shares of Common Stock of the Corporation or options or warrants relating thereto or securities convertible into such Common Stock, or any material change in the capitalization of the Corporation, or any material adverse change in the properties or condition (financial or otherwise) of the Corporation, or any other material adverse occurrence affecting the Corporation, the Purchaser or this offer, or the Corporation shall enter into any transaction, agreement or commitment not in the ordinary course of business or dispose of any substantial part of its assets, or any action or proceedings shall be brought or threatened against the Purchaser or any Co-Depositary arising out of this offer, the Purchaser may, at its election by notice in writing to the Co-Depositaries, withdraw this offer and terminate all obligations of the Purchaser to purchase shares hereunder.

G. H. Walker & Co., 45 Wall Street, New York, N. Y. 10005, and Scherck, Stein & Franc, Inc., 408 Olive Street, St. Louis, Mo. 63102, are acting as Dealer Managers in connection with this offer. Additional copies of this Offer Letter and the Letter of Transmittal can be obtained from the Dealer Managers or from the Co-Depositaries at the addresses given above.

Very truly yours,

Emerson Electric Co.

This offer expires at 5:00 P.M., Chicago time, on June 2, 1967 unless otherwise extended by the Purchaser as hereinabove provided.

For your shares to be eligible for purchase, your Letter of Transmittal must be received by a Co-Depositary before the expiration of this offer.

STIPULATION EXHIBIT 1.2.

STATEMENT OF VALUE

Emerson Electric Tender Offer for Dodge Manufacturing Corporation

Emerson Electric Co., St. Louis, has offered to purchase for $63.00 per share up to 550,000 shares of Dodge Manufacturing Corporation, Mishawaka, Indiana. The Emerson offer, which terminates unless extended, at the close of business on June 2, 1967 provides that all Dodge shares up to 550,000 will be purchased provided at least 460,000 shares are tendered. However, Emerson reserves the right to purchase all shares regardless of the number tendered.

Dodge is a producer of mechanical power transmission equipment, including such products as chain drives, couplings, V-Belt drives, friction clutches, pulleys and speed reducers. The sale of these products is closely tied to the level of plant equipment expenditures. Emerson Electric is a broadly diversified manufacturer of electrical and electronic products, systems and controls.

Dodge's earnings per share for the fiscal year ended June 30, 1966 were $3.52. Earnings for the last 12 months ended March 31, 1967 were $3.61 per share. For the quarter ended March 31, 1967 Dodge's earnings per share were $.84, down 17% from $1.01 for the comparable period a year ago.

The high-low market prices of Dodge Common Stock on the Midwest and New York Stock Exchanges for the

period 1964-1966, according to published information, were as follows:

	High	*Low*
1964	29⅞	24¾
1965	36⅞	26
1966	41	31⅝

The historical high for the common stock of Dodge up to this year was $41.00 per share. The market price during 1967 has ranged from a low of $38.25 on January 4, to $56.75 on March 23. On February 28, Emerson made a final proposal for a tax-free merger of the two companies. Following this proposal, the Dodge common stock price rose to a high of $56.75 on March 23 when the Dodge Board rejected this offer and Emerson formally withdrew it. The market price of Dodge common subsequently declined to the level of $44.75, the closing price on May 19.

We consider the offer of $63 per share to be favorable to the Dodge shareholders. The closing market price of Dodge on the New York Stock Exchange on Friday, May 19, 1967, the last trading day prior to the tender announcement, was $44.75. The offer of $63 per share represents a premium of $18.25 over this level and provides to Dodge shareholders a market appreciation of approximately 40%.

Based on fiscal 1966 earnings of $3.52 per share, the price/earnings ratio at the tender price of $63.00 is 17.9X. On the last 12 months earnings of $3.61, the price/earnings multiple is 17.5X. The common stocks of companies who manufacture products comparable to those of Dodge are currently trading at multiples of approximately 9-12X latest 12 months earnings. Dodge's book value at June 30, 1966 was $18.12. The company currently pays a dividend of $1.80 per share which represents a yield of 2.85% based on the tender price of $63.00.

By any standard, we believe the Emerson offer is generous to Dodge shareholders and will be favorably received by them. Dodge holders should tender their stock as expeditiously as possible so as to ensure having it purchased.

G. H. Walker & Co.
Dealer Manager

May 22, 1967

STIPULATION EXHIBIT 1.3.

Offer Terminates at 5:00 P. M., Chicago Time, on June 2, 1967 Unless Extended

LETTER OF TRANSMITTAL

Tender of Shares of Dodge Manufacturing Corporation in Acceptance of Offer

Important: This form should be completed and sent to a Co-Depositary named below, together with your certificates for the Common Stock of Dodge Manufacturing Corporation. Your Broker or Bank Will Assist You in Completing This Form.

To: First National Bank of Chicago, Co-Depositary
38 South Dearborn Street
Chicago, Illinois 60690

Marine Midland Grace Trust Co. of New York,
Co-depositary
140 Broadway
New York, New York 10015

St. Louis Union Trust Co., Co-Depositary
510 Locust Street
St. Louis, Missouri 63101

Dear Sirs:

The undersigned hereby acknowledges receipt of and irrevocably accepts (with respect to the shares deposited herewith or tendered hereby) the offer of Emerson Electric Co. (herein called the "Purchaser"), contained in the Offer Letter, dated May 22, 1967, of the Purchaser to purchase 550,000 shares of the Common Stock of Dodge Manufacturing Corporation (herein called the "Corporation") upon the terms and conditions set forth therein and upon the reverse side hereof, and in accordance therewith the undersigned hereby delivers or agrees to deliver to one of the above named Co-Depositaries (herein called "you") for such transfer and sale to the Purchaser the following certificates for shares of the Common Stock of the Corporation.

Certificate
Number(s) if available _____

Total Number of
Shares Represented
by Certificates _____

Number of*
Shares Tendered _____

* All shares represented by certificates listed are deemed to have been tendered unless otherwise indicated in this space.

Note: If additional space is required, attach a separate schedule.

The undersigned hereby warrants that the undersigned has full authority to sell and transfer the above mentioned shares, and that the Purchaser will acquire good title thereto, free and clear of all liens, charges and encumbrances and not subject to any adverse claim, when the same are purchased by it. The undersigned will, upon request, execute any additional documents necessary or desirable to complete the sale and transfer of the above-described shares.

Assignment

In consideration of the offer cited above and the payment of the purchase price specified therein, the undersigned hereby sells, assigns and transfers unto the Purchaser or its order so many of the shares of Common Stock of the Corporation represented by the above-described certificates as you may designate, and hereby irrevocably constitutes you as attorney to effectuate the transfer of said shares on the books of the Corporation with full power of substitution in the premises.

All authority herein conferred or agreed to be conferred shall survive the death or incapacity of the undersigned, and all obligations of the undersigned hereunder shall be binding upon the heirs, personal representatives, successors and assigns of the undersigned.

You are to deliver the stock certificates (or such portion thereof as represents shares being purchased), together with all accompanying evidences of authority, to or upon the order of the Purchaser against receipt by you as agent for the undersigned of the purchase price for such shares stated in the aforesaid offer. Delivery by you of such stock to the Purchaser shall be conclusive as to the performance of all conditions necessary to make this Letter of Transmittal effective.

If the certificates representing the shares tendered hereby are not delivered herewith, a member firm of the New York or the American Stock Exchange or a commercial bank or trust company having an office or correspondent in the cities of Chicago or New York must guarantee in the space provided below that such certificates will be deposited with you no later than 8 business days after dispatch of notice by you to such member, bank or trust company that this tender has been accepted by the Purchaser.

To Be Used Only If Certificates Are *Not* Delivered Herewith

The undersigned,

☐ a member of the New York or the American Stock Exchange,

☐ a commercial bank having an office or correspondent in the cities of Chicago or New York,

☐ a trust company having an office or correspondent in the cities of Chicago or New York,

guarantees to deliver to a Co-Depositary (in proper form for transfer) certificates for the shares tendered by this Letter of Transmittal not later than 8 business days after notice of acceptance thereof by the Purchaser is dispatched by such Co-Depositary.

Sign Here _____

Authorized Signature

Please issue the check for the purchase price to the order of the undersigned and mail it to the address shown below. If any of the shares mentioned above are not purchased by the Purchaser, please return the stock certificates representing such shares (and accompanying documents, as appropriate) to the undersigned at the address shown below.

The undersigned understands and agrees that you shall not be liable hereunder for any act or omission of the Purchaser.

Dated _____, 1967.

Very truly yours,

Please ☞ _____
Sign

_____

Signature(s) of registered holder. (Must be signed by registered holder(s) exactly as name appears in certificate(s) or by person(s) authorized to become registered holder(s) by certificates and documents transmitted or to be transmitted in the case of guaranteed certificates.)

Print Name _____
and Address _____
_____
Zip

The undersigned represents that the securities dealer who solicited and obtained this tender is:

Use the following space only if this tender was solicited by a qualified dealer.

Name _____
Address _____
_____

A member of a national securities exchange or of the National Association of Securities Dealers,

Inc. or a non-member foreign dealer who has agreed to conform to the Rules of Fair Practice of the NASD.

The instructions on Reverse Side must be followed.

Do Not Write in This Space

Shares Received:	Date Mailed:	Processed By:
Shares Accepted:	Check No.	Amount $
Shares Returned:	Certificate No.	Mail No.

Dealer Commission; Date and Amount:

STIPULATION EXHIBIT 1.4.

INSTRUCTIONS FOR
TENDER OF SHARES IN ACCEPTANCE OF OFFER

1. Each holder of the Corporation's Common Stock desiring to accept the offer should as soon as possible mail or deliver this Letter of Transmittal completely filled in and signed as specified herein together with the certificates representing his shares (unless delivery has been guaranteed as provided herein) and all documents required below, if any, to a Co-Depositary named on the reverse side.

2. Stock certificates must be either (a) duly endorsed in blank or (b) accompanied by duly executed stock powers with, in either case, signatures guaranteed by a commercial bank or trust company having an office or correspondent in Chicago or New York, or a broker who is a member of the New York or American Stock Exchange.

3. If this instrument is executed by an officer on behalf of a corporation, or by an executor, administrator, trustee, guardian, attorney, agent or other person acting in a fiduciary or representative capacity, proper documentary evidence must be furnished of the authority of the person executing the same. In cases where the person signing the Letter of Transmittal is not the registered holder of the stock certificates tendered thereby, such certificates must either be endorsed in blank or accompanied by duly executed stock powers, signature guaranteed, evidencing proper assignment of the tendered shares to the person signing such Letter of Transmittal. All questions as to the validity, form, eligibility (including time of receipt) and acceptability of any tender of shares will be determined by the recipient Co-Depositary in its sole discretion and such Co-Depositary may require whatever additional documentation it deems necessary to perfect any tender or transfer.

4. No stock transfer tax stamps, or funds to cover such stamps, need accompany this instrument. The Purchaser will pay any stock transfer taxes applicable to the transfer and sale to it. However, if payment of the purchase price is to be made to an assignee of the registered holder, or if deposited stock certificates are not registered in the name of the person signing the Letter of Transmittal, the amount of any stock transfer taxes on account of the transfer to such assignee or such person will be deducted from the purchase price, if evidence of the payment of such tax is not submitted.

5. The method of delivery of this instrument, the stock certificates, and documents (if any) is at the option and risk of the holder, but the delivery will be deemed effective for the purpose of having the tendered shares considered for purchase only when actually received by a Co-Depositary. If such delivery is by mail, it is suggested that insured registered mail be used.

6. No alternative, conditional or contingent tender will be accepted.

7. The Purchaser, entirely at its election, may waive any of the specified terms and conditions of its offer, in the case of any share or shares tendered or purported to be tendered.

STIPULATION EXHIBIT 1.5.

OFFER TO PURCHASE COMMON STOCK OF DODGE MANUFACTURING CORPORATION AT $63 PER SHARE

To Securities Dealers:

For your information as a possible soliciting dealer, we are enclosing herewith the following material relating to the offer of Emerson Electric Co. (the "Purchaser"), to purchase shares of Common Stock of Dodge Manufacturing Corporation ("Dodge"):

(1) Copy of the Offer Letter, dated May 22, 1967, to holders of Common Stock of Dodge.

(2) Form of Letter of Transmittal.

(3) A printed form of letter to be sent to your customers for whose account you hold Common Stock of Dodge registered in your name, with a perforated attachment for obtaining such customers' instructions with regard to the offer.

Please note that, unless extended, the offer terminates at 5:00 P. M., Chicago time, on June 2, 1967.

A fee of 90¢ per share purchased in accordance with the terms of the offer will be paid to any member of a national securities exchange or of the National Association of Securities Dealers, Inc. (or any foreign dealer not eligible for membership in such Association who has agreed to conform to the Rules of Fair Practice of such Association) who solicits tenders and whose name appears

in the appropriate space provided in the Letter of Transmittal accompanying a tender. No dealer is required to charge his principal an additional commission. Transfer taxes payable on the transfer of shares to the Purchaser will be paid by the Purchaser.

Additional copies of the enclosed material may be secured from First National Bank of Chicago, 38 South Dearborn Street, Chicago, Ill. 60690; Marine Midland Grace Trust Co. of New York, 140 Broadway, New York, N. Y. 10015; St. Louis Union Trust Co., 510 Locust Street, St. Louis, Mo. 63101; G. H. Walker & Co., Rm. No. 2057, 208 South La Salle Street, Chicago, Ill. 60604 or 45 Wall Street, New York, N. Y. 10005; or Scherck, Stein & Franc, Inc., 408 Olive Street, St. Louis, Mo. 63102.

Very truly yours,

G. H. Walker & Co.
Scherck, Stein & Franc, Inc.

Nothing contained herein or in the enclosed documents shall constitute you the agent of G. H. Walker & Co., Scherck, Stein & Franc, Inc. or Emerson Electric Co. or authorize you to make any statements on their behalf with respect to the offer described in the enclosed letter other than the statements specifically set forth in the letter.

STIPULATION EXHIBIT 2.1.

(Letterhead of Bryan, Cave, McPheeters & McRoberts
St. Louis, Missouri 63102)

June 26, 1967

Mr. W. R. Persons
Chairman of the Board of Directors
Emerson Electric Co.
8100 Florissant Avenue
St. Louis, Missouri 63136

Re: *Dodge*

Dear Buck:

Emerson, on or about June 16, 1967, purchased approximately 152,000 shares of the Common Stock of Dodge, at a net price to the selling stockholders of $63.00 per share. The actual cost to Emerson because of brokerage and other expenses was somewhat higher than this per share amount, but, for purposes of the following discussion, this $63.00 amount will be assumed and the following additional assumptions will be made:

Dodge outstanding Common Stock	1,150,000
Number of shares purchased by Emerson	152,000
Shares now owned by Emerson as per cent of total outstanding	13.3%.
Total cost of shares purchased by Emerson	$9,576,000
Shares required to be sold by Emerson to reduce holding to less than 10%	37,100

While these assumptions are substantially factual, since they are assumptions, any action taken in connection with the matters discussed below should be related to precise computation of any of these assumptions which may be relevant.

It is possible that, because of a better Reliance proposal or otherwise, Emerson may not want to pursue a proxy contest with Dodge and may want to consider alternatives, principally, how to dispose of, at a profit, the shares of Dodge stock which Emerson now owns. There

are tax considerations and Section 16(b) considerations to be taken into account on any such sale.

Tax Considerations

The primary tax objective will be the realization of long-term gain if the shares are sold at a profit. In order to have long-term gain, the holding period must be greater than six months. On the assumption that the Dodge shares were purchased on June 16, 1967, the sales date (for long-term gain purposes) can be no earlier than December 17, 1967. However, since as to some of the Dodge shares, Emerson's purchase thereof for tax purposes may actually have been made after June 16, 1967, the December 17, 1967 date should not be regarded as a completely safe date. The facts regarding the exact date of purchase for tax purposes of any shares sold should be carefully checked before any sale of such shares is made.

If, for the 16(b) reasons discussed below, a part of the Dodge shares are sold before the expiration of the six month holding period, any gain realized on such sale will be short-term.

If any contract is made to sell the Dodge shares, the critical date for tax purposes will not be the date the contract of sale is made, but will be the date on which the shares are actually sold under the contract. Also, for tax purposes, the receipt of Reliance preferred shares on the merger of Dodge into Reliance will not be a "sale" of the Dodge shares; and the Reliance shares received on the merger will have the same carry-over tax basis as the Dodge shares exchanged on the merger.

Thus, for tax purposes, it would be possible to obtain long-term gain by deferring the sale of the Dodge or Reliance shares until the expiration of the six month holding period. This same result could be achieved even though a firm contract for the sale of the shares, at a profit, was made prior to the expiration of the holding period, provided, however, that the actual consummation of the sale was deferred under the contract until after

the end of the six month period. The same is not true in respect of Section 16(b) considerations, discussed below.

Section 16(b)

On June 16, 1967, by its acquisition of more than 10% of the Common Stock of Dodge, Emerson came within the purview of Section 16 of the Securities Exchange Act of 1934.

Section 16(b) of the 1934 Act provides, in part:

> "* * * any profit realized by [the beneficial owner of more than 10% of any class of equity security of an issuer which is registered on a national securities exchange] from any purchase and sale or any sale and purchase of any equity security of such issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer * * *".

This sometimes is known as the "short swing profit" provision of the Act, and, briefly, means that the profit on a purchase and sale within the specified six month period will be required to be paid over to the security issuer if a proper suit for the recovery of such profit is initiated.

There is, first of all, some question as to whether the initial purchase by which Emerson for the first time became a greater than 10% stockholder of Dodge, should be taken into account for purposes of Section 16(b). Without discussing at length this technical question, we will simply point out that the Court of Appeals of the Second Circuit in *Stella v. Graham-Paige Motors Corp.*, 232 Fed. 2d 299, held that, for purposes of Section 16(b), the initial purchase of more than 10% of the equity securities of an issuer should be taken into account. There was a strong dissenting opinion in the *Graham-Paige* case and this dissent was followed by an Arkansas District Court in *Arkansas Louisiana Gas Co. v. W. R. Stephens Investment Co., Inc.*, 141 Fed. Supp. 841. There are also conflicting viewpoints expressed by writers of law texts and articles who have considered this matter.

Our view is that since this uncertainty exists, Emerson should proceed on the assumption that 16(b) does apply and should seek to avoid its consequences. On the other hand, Emerson should know that if it makes a short-term sale of all or part of its shares at a profit, it may be able to defend successfully against a claim of applicability of 16(b).

Assuming, then, that 16(b) does apply and that, under 16(b), Emerson "purchased" 13.3% of the Dodge shares on June 16, 1967, it will be considered to have "sold" these shares for 16(b) purposes as a result of the merger of Dodge and Reliance if the latter occurs. On this "sale" the Reliance preferred shares received will be deemed to be the sale consideration, and, if these shares have a value in excess of Emerson's cost basis of its Dodge shares (which is more than $63.00 per share), Emerson will have a profit for 16(b) purposes which, if 16(b) applies, Emerson could be required to pay over to Reliance.

The time of this "sale" on the Dodge-Reliance merger is difficult to state with certainty. Again, without going into the technical discussion, the time of such sale may be deemed to be as early as the time of the vote by the Dodge and Reliance stockholders on the merger proposal, although, more likely, we believe it would be held to be as of the time of the reapproval of the merger by the Dodge directors. As a precautionary measure, however, defensive action against 16(b) possibilities should be taken before the date of the Dodge stockholders' meeting.

The initial defensive step which should be taken by Emerson, if it comes to the conclusion that the Dodge-Reliance proposal will succeed, is for Emerson to reduce its holdings of Dodge stock to less than 10%. This means the gift or sale, prior to August 22, 1967, of 37,100 shares of the Dodge stock owned by Emerson. From this point on, Emerson, no longer being a 10% stock owner of Dodge, can sell the balance of its Dodge stock free of any 16(b) risk; provided, of course, the second sale is not legally tied in any way to the first sale. However, if the 37,100

shares are sold and such sale is at a profit, there is the risk of a suit being initiated seeking to compel Emerson to pay over this profit to Reliance on the basis that the sale is within the pay-over provisions of 16(b). It is in this suit, if it occurs, that Emerson would have to raise the defense of the non-applicability of 16(b). The success of this defense is, as noted, uncertain, but it should be remembered that it would involve only the profit realized on the sale of 37,100 shares; and any profit realized on a subsequent unrelated sale of the remaining 114,900 shares would not be in jeopardy under 16(b).

These distinctions between the tax and 16(b) considerations should be borne in mind: The merger of Reliance and Dodge would not effect a "sale" of Dodge shares for tax purposes; it would for 16(b) purposes. The making of a firm contract to sell the Dodge shares would not constitute a "sale" for tax purposes; it would for 16(b) purposes. For the latter reason, no contract of sale of the Dodge shares should be made within the six month period until Emerson has first reduced its Dodge holdings to less than 10%.

Bargain Sale to Charity

We have discussed with you briefly the possibility that Emerson, to avoid paying any profit on a sale of its Dodge shares to Reliance, might sell a part of the shares to a charity at Emerson's cost basis. This remains as a possibility, but it has some inherent problems. One, if Emerson required the charity to sell the shares or to vote against the merger, or attempted to obtain any tax benefit for the bargain sale, or attempted to use the bargain sale in satisfaction of any pledge liability to the charity, there is a risk that Emerson might be deemed to have sold, indirectly, the shares involved. If so, 16(b) and tax problems would remain. While some isolation from these problems might be established by a sale to a charity, we do not believe this can be regarded as a completely satisfactory solution to the problem. We will be happy to discuss this further with you.

Settlement with Dodge and Reliance

It may be possible at sometime before the Dodge-Reliance merger vote to agree upon a settlement with these companies under a negotiated agreement providing for the purchase of the Dodge shares owned by Emerson and/or the Reliance preferred shares to be received if the Dodge-Reliance merger is effected. It seems necessary, however, that any such settlement provide for a sale by Emerson of at least 37,100 of its Dodge shares before the August 22, meeting date. If this sale should involve a profit, the profit would be short-term and might be subject to recovery by Reliance under 16(b). If this sale did not involve profit and the profit was written into a contemporaneous option contract or other arrangement with Dodge and/or Reliance relating, to the sale of the balance of Emerson's Dodge shares, there would exist the risk that the two transactions might be tied together with adverse tax and/or 16(b) consequences. Any settlement arrangement of this nature should have prior detailed consideration and careful review, with the factors noted above in mind.

Summary

Because of the many considerations discussed above which are involved in any arrangement which may be made, relating to the disposition of the Dodge shares, no final summary for guidance is practical at this time. The immediate conclusion is that, because of the 16(b) risks noted, if it is determined that the Dodge-Reliance proposal has a reasonable likelihood of success, or Emerson determines to abandon its merger attempt, it is important for Emerson to reduce its holdings of Dodge stock to less than 10% prior to the Dodge stockholders' meeting.

Yours very truly,

Bryan, Cave, McPheeters & McRoberts

By /s/ Thomas V. Connelly

TVC/mcb

STIPULATION EXHIBIT 2.2.

(Letterhead of Bryan, Cave, McPheeters & McRoberts
St. Louis, Missouri 63102)

(Handwritten note: Photo of original as sent to Persons on July 8, after phone call discussion of its contents with him. T. V. C.)

July 7, 1967

Mr. W. R. Persons
Chairman of the Board of Directors
Emerson Electric Co.
8100 Florissant Avenue
St. Louis, Missouri 63136

Dear Buck:

Enclosed is a copy of an article in the Wall Street Journal of June 30, 1967 re: suit against Occidental Petroleum over settlement of its shareholdings in Kern County Land Co. by a side transaction with Tenneco, Inc. You may have noted this. It points out one of the problems involved in any possible "deal" with Dodge and/or Reliance for the Dodge shares owned by Emerson.

The apparent decisions made yesterday (i) to proceed with an immediate letter to Dodge stockholders asking them to withhold their proxies until the Emerson story is told, and (ii) to proceed with litigation to enjoin the holding of the Dodge meeting on August 22, 1967 will commit Emerson rather completely to proceed with a proxy fight against the Reliance-Dodge merger proposal. While withdrawal may be possible after either or both of these steps is taken, it will be more difficult. This, of course, will not necessarily be the case if a subsequent withdrawal is precipitated by an improvement in the Reliance offer or by any other event materially changing current circumstances. As Emerson proceeds further in this matter, however, the likelihood of litigation on a subsequent withdrawal from the proxy contest (particularly, if coupled

with any settlement of Emerson's Dodge share ownership) is increased.

At the present time, in view of the rejection of the Emerson proposal by the Dodge directors and in view of changed market conditions, Emerson could withdraw from the anticipated proxy fight with Dodge with reasonably minimal risk of litigation. There are some risks even in this, since Emerson agreed to keep its offer open until October 25, 1967 and since the rejection by Dodge directors of the Emerson proposal is not completely unequivocal. If any Emerson decision to withdraw at this time is made, we believe it should be announced and should not be coupled with any settlement agreement with Dodge or Reliance.

If Emerson because of 16(b) considerations should determine to sell its shares of Dodge Common Stock in the open market or privately, we believe it would be necessary first to announce both *the withdrawal of the Emerson merger offer to Dodge and Emerson's intention not to pursue a proxy fight on the Reliance-Dodge merger.

Also, if it is anticipated that somewhere down the road, Emerson might withdraw from any proxy fight with Dodge, this possibility should be mentioned in Emerson's proxy statement to its shareholders.

These somewhat random comments are made in connection with your indicated intent to make a final decision by Monday either to proceed or withdraw. The sum effect is that such a decision should be regarded as substantially final and that "half-way forward" is not really possible from this point.

In respect to litigation to enjoin the Dodge shareholders' meeting, the probabilities seem to us to be (if the Court finds Dodge guilty of 14A violations) that the meeting would be enjoined until the Dodge stockholders were re-circulated with full information concerning the Emerson proposal; but we would not expect the courts to usurp the directors' functions by compelling submission of the

Emerson merger proposal directly to the Dodge stockholders.

Yours very truly,

Bryan, Cave, McPheeters & McRoberts
By /s/ Thomas V. Connelly

TVC/mcb

Enclosure

(Handwritten footnote:

* More accurately—announce intention to sell Dodge shares to reduce holdings to less than 10%. Not necessary to withdraw Emerson merger proposal to Dodge.)

STIPULATION EXHIBIT 3.1.

Emerson Electric Co.
8100 Florissant Avenue
St. Louis, Mo. 63136

August 29, 1967

Mr. Arthur Shoults
Goldman, Sachs & Company
314 North Broadway
St. Louis, Missouri

Dear Mr. Shoults:

As you were advised, on August 28, 1967 we sold to Goldman, Sachs & Company 37,000 shares of Dodge Manufacturing Corporation Common Stock at a price of $68.00 per share. This sale was arranged by Mr. W. L. Davis, President of Emerson Electric Co., with Mr. L. Jay Tenanbaum of your New York office.

As arranged with you, we deliver herewith Dodge Manufacturing Corporation Common Stock Certificate No. NU32 for 46,302 shares. Attached to the certificate is a

power of attorney signed by Mr. J. C. Wilson, Vice President of the Company, and a Certified Copy of a Resolution of the Board of Directors of this Company adopted in an Adjourned Special Meeting of the directors held June 17, 1967.

The net payment of $2,497,153.68, after deductions for commissions of $16,946; New York State Stock Transfer Tax of $1,850 and New York Stock Exchange Fee of $50.32, is to be deposited to the credit of Emerson Electric Co. in our General Bank Account No. 1-70935-6 at Marine Midland Grace Trust Company of New York, 140 Broadway, New York, New York. We understand that payment will be made to us on Friday, September 1, 1967.

Would you please acknowledge receipt of the certificate for the 46,302 shares on the attached copy of this letter.

Very truly yours,
/s/ G. W. Mellicker
Treasurer

GWM/ds
Encls.
cc: Mr. L. Jay Tenanbaum

(Handwritten note: Received ctf for 46,302 shares August 29, 1967 Goldman, Sachs & Co. (Illegible) Cashier.)

STIPULATION EXHIBIT 4.1.

PURCHASE AGREEMENT

This purchase agreement entered into this 11th day of September, 1967, between Dodge Manufacturing Corporation, an Indiana corporation ("Dodge"), and Emerson Electric Co., a Missouri corporation ("Emerson"),

WITNESSETH:

WHEREAS, Emerson owns 115,282 shares of Common Stock, par value $2.50 per share, of Dodge ("the Shares"); and

WHEREAS, Dodge has 1,157,437 shares of Common Stock issued and outstanding on the date hereof, excluding 732 shares held in its Treasury; and

WHEREAS, Emerson desires to sell and Dodge desires to purchase the Shares on the terms and conditions herein set forth;

NOW, THEREFORE, the parties agree as follows:

1. Emerson agrees to sell the Shares, and Dodge agrees to purchase the Shares, at a purchase price of $69 per share or an aggregate price of $7,954,458.

2. The sale and purchase of the Shares shall be carried out at the office of Bryan, Cave, McPheeters & McRoberts in St. Louis, Missouri, at 11:00 A.M., St. Louis time, on September 13, 1967 or at such other time and place as shall be agreed by Emerson and Dodge. Such time is herein referred to as the "Closing Date." At the Closing Date Emerson shall deliver to Dodge stock certificates in the name of Emerson representing all of the Shares either duly endorsed in blank or with duly executed stock powers in blank (in either case with signatures guaranteed by a commercial bank or trust company or by a brokerage firm having membership on the New York Stock Exchange), accompanied by such supporting documents as may be necessary to pass to Dodge full title to the Shares, free and clear of any lien, encumbrance, restriction, charge or equity. Emerson shall pay, or cause to

be paid stamp taxes or other transfer taxes, if any, attributable to the sale. Such delivery shall be made against payment by Dodge of the aggregate purchase price for all of the shares through wire transfer of federal funds to the account of Emerson at a bank designated by Emerson.

3. Emerson agrees:

(a) That it will take no action to interfere with, prevent or otherwise obstruct the consummation of the proposed merger of Dodge into The Reliance Electric and Engineering Company;

(b) That it will forthwith dismiss with prejudice its complaint in Civil Action #4050, entitled "Emerson Electric Co., Plaintiff v. Dodge Manufacturing Corp., et al., Defendants" pending in the U. S. District Court for the northern district of Indiana and its appeal in case number 16398, entitled "Emerson Electric Co., Plaintiff-Appellant v. Dodge Manufacturing Corp., et al., Defendants-Appellees," now pending in the United States Court of Appeals for the Seventh Circuit, and that it will bring no other action against the defendants named in the aforementioned proceedings, or any of them, based on the alleged facts and claims forming the basis of the complaint and attempted amendment and supplement to the complaint in such proceedings; and

(c) That it hereby waives, releases and foregoes any rights it may have as a dissenting shareholder of Dodge under the laws of the state of Indiana.

4. Emerson shall not be obligated to sell any of the Shares, unless at the Closing Date it shall have received the written opinion of Messrs. Hopkins, Sutter, Owen, Mulroy, Wentz & Davis, counsel for Dodge, to the effect that (i) this Purchase Agreement has been duly authorized, executed and delivered on behalf of Dodge and constitutes its valid and binding obligation, and (ii) Dodge has the full right, power and authority to purchase the Shares pursuant to this Purchase Agreement.

5. Dodge shall not be obligated to purchase any of the Shares unless at the Closing Date it shall have received the written opinion of Messrs. Bryan, Cave, McPheeters & McRoberts, counsel for Emerson, to the effect that (i) this Purchase Agreement has been duly authorized, executed and delivered on behalf of Emerson and constitutes its valid and binding obligation, and (ii) Emerson has the full right, power and authority to sell the Shares pursuant to this Purchase Agreement and upon completion of the deliveries contemplated to be made at the Closing Date, Dodge will become the owner of the Shares free and clear of all liens, encumbrances, charges and equities.

6. Dodge and Emerson each represent to the other that it has not dealt with any broker or finder in connection with this Purchase Agreement or the sale and/or purchase of the Shares contemplated hereby and each will indemnify the other and hold the other harmless from any liability, loss, cost or expense resulting in the event that its representations should prove untrue.

7. This Purchase Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns.

8. This Purchase Agreement shall be construed in accordance with and governed by the laws of the state of Missouri.

IN WITNESS WHEREOF, this Purchase Agreement has been duly executed all as of the day and year first above set forth.

Dodge Manufacturing Corporation
By /s/ Carl W. Peterson
Executive Vice President

By /s/ Karl D. Jahnke
Secretary

Emerson Electric Co.
By /s/ W. L. Davis—Pres.
By /s/ R. H. McRoberts, Sec.

STIPULATION EXHIBIT 4.2.

(Letterhead of Emerson Electric Co.,
St. Louis, Mo. 63136)

September 11, 1967

Dodge Manufacturing Corporation
Mishawaka, Indiana

Gentlemen:

As further consideration for the execution of a certain Purchase Agreement between us, dated September 11, 1967, relating to the purchase and sale of 115,282 shares of Dodge stock owned by Emerson, Emerson agrees that any tax ruling received by Emerson from the I. R. S. relating to a proposed merger between Dodge and Emerson, shall not be used by Emerson, directly or indirectly, as the basis for any claims or court proceedings of any kind against Dodge or any of its employees, officers or directors.

Yours very truly,

/s/ W. L. Davis
W. L. Davis, President

WLD/ob

STIPULATION EXHIBIT 4.3.

(Letterhead of Bryan, Cave, McPheeters & McRoberts, St. Louis, Missouri 63102)

September 11, 1967

Dodge Manufacturing Corporation
Mishawaka
Indiana

Gentlemen:

We are counsel for Emerson Electric Co. We are familiar with the circumstances relating to the purchase by Emerson Electric Co. (Emerson) of 152,282 shares of the Common Stock of Dodge Manufacturing Corporation (Dodge), the subsequent sale of 37,000 of said shares by Emerson on or about August 28, 1967 and the proposed sale to Dodge by Emerson of the remaining 115,282 shares of said stock under the terms of a contract between Emerson and Dodge dated September 11, 1967, in which Dodge has represented that it has 1,157,437 shares of Common Stock issued and outstanding, excluding 732 shares held in its treasury.

Based on our familiarity with the facts and circumstances relating to such purchase and sales, it is our opinion that the proposed sale to Dodge of said 115,282 shares of the Common Stock of Dodge will not involve the realization of profit by Emerson subject to recovery by Dodge, its successors or assigns, under the provisions of Section 16(b) of the Securities Exchange Act of 1934.

Very truly yours,

Bryan, Cave, McPheeters & McRoberts
By /s/ R. H. McRoberts
R. H. McRoberts

RHMcR/em

STIPULATION EXHIBIT 4.4.

September 11, 1967

Emerson Electric Co.
8100 Florissant Avenue
St. Louis, Missouri 63136
Attention: Mr. W. R. Persons
Chairman

Gentlemen:

In connection with the proposed Purchase Agreement between Emerson Electric Co. ("Emerson") and Dodge Manufacturing Corporation ("Dodge") relating to the sale of 115,282 shares of Dodge stock by Emerson to Dodge, you have asked for the following representation from the undersigned as to the intentions of the management of Dodge.

Based upon the facts as stated in the letter opinion of even date herewith from Bryan, Cave, McPheeters & McRoberts, addressed to Dodge, and upon your representation that the sale of 37,000 shares of Dodge stock made by Emerson on or about August 28, 1967 was a sale to Goldman Sachs & Co. for its own account or for a customer or customers of that company, having no connection with Dodge or Reliance to the knowledge of Emerson or of the undersigned, and upon the opinions which their counsel have given to Dodge and Reliance, you are advised that neither the management of Dodge nor of Reliance has any intention of asserting any claim under Section 16(b) of the Securities and Exchange Act of 1934 for any so-called "short-swing" profits which Emerson may realize on the aforementioned sale of $115,282 shares of Dodge stock to Dodge; provided, however, that we do not hereby make any representation with respect to any action which may or may not be taken by any shareholder of Dodge or Reliance nor any action which the manage-

ment of either Dodge or Reliance may deem necessary to take because of any such shareholder action.

Very truly yours,

/s/ Harry D. Orr, Jr.
Harry D. Orr, Jr. of
Hopkins, Sutter, Owen, Mulroy, Wentz & Davis
Counsel for Dodge

/s/ Stephen J. Burns
Stephen J. Burns
Secretary and General Counsel of Reliance

/s/ Joseph E. Mullaney
Joseph E. Mullaney of
Jones, Day, Cockley & Reavis
Counsel for Reliance

STIPULATION EXHIBIT 4.5.

(Letterhead of Bryan, Cave, McPheeters & McRoberts
St. Louis, Missouri 63102)

September 13, 1967

Dodge Manufacturing Corporation
Mishawaka
Indiana

Gentlemen:

We refer to the Purchase Agreement dated September 11, 1967 (the Purchase Agreement) between Dodge Manufacturing Corporation (Dodge) and Emerson Electric Co. (Emerson) providing for the purchase, this date, by Dodge from Emerson and for the sale, this date, by

Emerson to Dodge of 115,282 shares of the Common Stock, $2.50 par value per share of Dodge (the shares).

We are counsel for Emerson and, as such, are familiar with its Articles of Incorporation and its Bylaws, each as amended to date, and all corporate proceedings of its stockholders and directors. We have made such other investigation as we deem necessary as the basis for the opinion hereinafter expressed.

Based on the foregoing, it is our opinion:

(i) the Purchase Agreement has been duly authorized, executed and delivered on behalf of Emerson and constitutes its valid and binding obligation, and

(ii) Emerson has the full right, power and authority to sell the shares pursuant to the Purchase Agreement and, upon completion of the delivery of the stock certificates for the shares on the date hereof in accordance with the terms of the Purchase Agreement, Dodge will become the owner of the shares, free and clear of all liens, encumbrances, charges and equities.

Yours very truly,

Bryan, Cave, McPheeters & McRoberts
By /s/ R. H. McRoberts

RHMcR/mcb

STIPULATION EXHIBIT 4.6.

(Letterhead of Hopkins, Sutter, Owen, Mulroy, Wentz & Davis, Chicago 60602)

September 13, 1967

Emerson Electric Co.
8100 Florissant Avenue
St. Louis, Missouri 63136

Gentlemen:

We are counsel for Dodge Manufacturing Corporation and as such are familiar with the terms and provisions of a certain Purchase Agreement dated September 11, 1967, between Dodge Manufacturing Corporation ("Dodge") and Emerson Electric Co. ("Emerson") relating to the purchase and sale of 152,282 shares of the Common Stock of Dodge. In this connection, and in accordance with Section 4 of said Purchase Agreement, we wish to advise that we are familiar with the corporate organization of Dodge, its Articles of Incorporation, By-Laws and the proceedings of the Board of Directors of Dodge relating to the authorization and execution of said Purchase Agreement.

Based on the foregoing, it is our opinion that said Purchase Agreement has been duly authorized, executed and delivered on behalf of Dodge and constitutes its valid and binding obligation in accordance with its terms and that Dodge has the full right, power and authority to purchase said 152,282 shares of its Common Stock from Emerson pursuant to said Purchase Agreement.

Very truly yours,

Hopkins, Sutter, Owen, Mulroy,
Wentz & Davis
By /s/ Harry D. Orr, Jr.

A Partner

HDO:phg

IN THE UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF MISSOURI, EASTERN DIVISION.

(Title omitted in printing.)

(1*) TRANSCRIPT OF PROCEEDINGS.

Be It Remembered, that this cause came on for hearing on the 3rd day of February, 1969, before

Honorable John K. Regan, Judge,

presiding in Court 3 of the United States District Court of the Eastern Division of the Eastern District of Missouri, with the following appearances:

For the Plaintiff:

Mr. R. H. McRoberts, Mr. Thomas C. Walsh.

For the Defendants:

Mr. Thomas P. Mulligan, Mr. Patrick J. Amer, Mr. Kenneth Teasdale.

(Before court convened, Plaintiff's Exhibits Nos. 1 through 33 were marked by the reporter for the purpose of identification.)

(2) (Index to Transcript of Proceedings omitted in printing.)

(3) The Court: I take it that the defendant's motion for production of, inspection and copying has never been called up, is moot?

Mr. Teasdale: That's correct, Your Honor.

The Court: All right. Let the record show that the defendant's motion for production, inspection and copying was never called up or presented, and apparently the plaintiff has produced, so it will be overruled as moot.

All right.

Mr. McRoberts: Your Honor please, with the permission of the Court, we propose to try only the issue of liability at this time, deferring to a later date the question of the amount of damages, if any.

---

* Boldface numerals in parentheses denote pagination of original typewritten transcript.

Of course, if there is no liability, that will become moot too.

The parties have stipulated certain of the facts in this case, and I would like to file this stipulation at this time.

(Document was handed to the clerk.)

I think it might be helpful if I would make a very brief—

The Court: Let me finish reading this Complaint, Mr. McRoberts.

Mr. McRoberts: Surely.

The Court: Okay.

(4) OPENING STATEMENT IN BEHALF OF PLAINTIFF:

Mr. McRoberts: As Your Honor will notice from the Complaint, this is a suit for declaratory judgment to determine whether or not Emerson Electric Company is liable to Reliance Electric for profits realized by it in the purchase and sale of stock of Dodge Manufacturing Company. Dodge was subsequently merged into Reliance, and that is why Reliance is a defendant here, although the dealings were with stock of Dodge.

There is, will be, I believe, no dispute about the basic facts in this case, or perhaps about any of the facts. Certain of them have been stipulated. Additional evidence we want to put in we think will help to determine whether or not this case does come within Section 16(b).

As Your Honor knows, the purpose of 16(b)—

The Court: Just a minute.

(There was a short interruption.)

The Court: All right. You may proceed.

Mr. McRoberts: Your Honor knows that 16(b) by its very terms was enacted for the purpose of preventing the unfair use of information which may have been obtained by any such beneficial owner, and such beneficial owner refers to one who owns more than ten per cent of the stock of the issuing corporation.

There is no doubt that Emerson purchased on June 16, 1967, 152,282 shares of Dodge Manufacturing Corporation. The (5) purchase was made pursuant to a request for tenders and Dodge stock was listed on the New York Stock Exchange. There is no dispute about the fact that on August 28th Emerson and Goldman, Sachs agreed to sell 37,000 of those shares to Goldman, Sachs, and on the 29th of August those shares were delivered to Goldman, Sachs pursuant to that agreement.

There is also no dispute about the fact that Reliance initiated about that same day, the 29th, conversations looking toward the purchase by Reliance of the remaining 115,282 shares, and that that sale to Reliance was consummated on the 13th of September, pursuant to a purchase agreement which was executed on the 11th of September. 37,000 shares brought Emerson's position in this stock to less than ten per cent of the issued and outstanding stock.

So we have two sales, and the question is, is Emerson liable to account under either one of those sales?

The evidence which we will propose to offer is primarily documentary. It will be supported with a brief narrative statement brought out by Mr. Persons to tell the circumstances under which the stock was purchased, the stock was dealt with by Emerson, the dealings between Emerson and Dodge, and the circumstances of the sale, and we believe that those facts will be of significance in three respects:

First, showing that the transaction was not one which (6) could possibly have led to the abuses to which this act is directed;

Second, that the first purchase, single purchase on June 16th, which brought Emerson, in one fell swoop, to the thirteen plus per cent of stockholdings in Dodge, does not come within the coverage of the act, and should be disregarded; and,

Finally, that the sale that was eventually made, sales that were eventually made, were made involuntarily in

the sense that they were under the pressure of the impending merger between Dodge and Reliance, which would have constituted a sale against our wishes, and would have imposed, might have imposed liability for profits on the entire transaction.

We think this comes squarely within the sentence from the Eighth Circuit Court of Appeals decision a couple of years ago in the case of Petteys v. Butler, where the Court said, "We believe that each case must be examined on its own facts," and the act only applied when these facts disclose the possibility of abuses that the acts were designed to prevent, and on the record we believe that this could not have been subject to the abuses which the act was designed to prevent.

Do you have any statement?

OPENING STATEMENT IN BEHALF OF DEFENDANT

Mr. Mulligan: May I, Your Honor?

The Court: Yes.

(7) Mr. Mulligan: I don't think, Your Honor, that—first of all, I appreciate the opportunity to address the Court, being a lawyer from another jurisdiction, both Mr. Amer and I wish to thank the Court for permission to appear before you.

I do not think I have anything to add to the basic facts which Mr. McRoberts stated. Those are truly the facts which give rise to the legal questions which are before Your Honor.

I think that basically we do have arising out of those facts which he stated a question which Your Honor will ultimately have to decide.

I might say at this point that it will be, generally speaking, our view that the legal questions are framed, and totally framed, by the stipulation which has been submitted to the Court, and that, in general, it is our view that the additional facts, the additional information which Mr. McRoberts indicated they would be prepared, on be-

half of the plaintiff, to offer testimony with respect to, is generally irrelevant to the basic legal issues which Your Honor has to decide, and which really get down to a question of determining what Congress intended when it passed Section 16(b).

Briefly, it is our position that that section was intended to squeeze all of the profit out of any transaction in which a person acquired more than ten per cent of the outstanding (8) shares of the issuer; that that situation does exist here, and that although there were two sales of the total stock acquired by Emerson, one sale of 37,000 shares, and another sale of 115,282, that those sales were so close in time that they can be said as a matter of law, on the basis of all the facts included in the stipulation, to be related; and, therefore, to constitute one transaction within the meaning of the act.

The Court: Was there something similar to this in that Georgia Pacific Frisco case?

Mr. Mulligan: I must confess, Your Honor, I am not familiar with that case.

The Court: I have forgotten. Bob, this had to do with that merger and they offered ten per cent.

Mr. McRoberts: I don't recall a Georgia Pacific case which had any bearing on this one.

The Court: Well, you ought to know.

Mr. Mulligan: Thank you, Your Honor.

(There was a short interruption.)

W. R. Persons, being first duly sworn, testified in behalf of the plaintiff as follows:

Direct Examination by Mr. McRoberts.

Q. Will you state your name, please, sir? (9) A. W. R. Persons.

Q. Where do you live, Mr. Persons? A. I live in St. Louis County.

Q. And what is your employment? A. I'm Chairman of Emerson Electric.

Q. Chief Executive Officer? A. Yes.

Q. And have been for some years? A. Yes.

Q. Were you such in 1966 and 67, Mr. Persons? A. I was.

Q. Did Emerson become interested in Dodge Manufacturing Company at or about the end of 1966, or early 1967? A. Yes.

Q. And how did you happen to become interested in Dodge? A. Well, we were interested in the developments that were taking place in this field. Dodge were manufacturers of transmission devices which would go in connection, in installation and connection with electric motors. There are several companies in that field, and some of these companies were joining in partnership with builders of electric motors and with speed reducer devices, conveyor companies, and we felt this represented a trend in that industry which could affect us as manufacturers of motors.

(10) Q. Was Dodge brought to your attention by any broker or intermediary? A. No, it was not. One of our divisions made a survey of such companies and presented a report to us.

Q. What information did you have about Dodge through this survey, or any other way?

Mr. Mulligan: Your Honor, in the interest of expediting things, and saving time, it is generally the position of Reliance in this litigation that testimony of the kind which is now being developed, and which I know from previous conversations with Mr. McRoberts he plans to develop, is irrelevant to the basic issues. I would like, if I may, sir, to enter an objection, and if it is agreeable to the Court, would it be possible to have a blanket objection to this line of testimony so that I need not interrupt Mr. McRoberts?

The Court: Let the record show that the defense has objected to—objects to this present testimony of this witness concerning the reasons they became interested in the purchase of Dodge stock, and any and all testimony relative to the manner in which they became interested, and

the manner in which they became aware of Dodge's business and operations as being immaterial and irrelevant to the issues of whether or not in this declaratory judgment action it is purely a matter of law as to whether or not the plaintiff, having been a ten per cent (11) owner of stock, enjoys any gain from the sale of that stock; isn't that your position?

Mr. Mulligan: Yes, it is. That is precisely it.

The Court: All right. I will take the objection, and it will be noted, and we will receive any and all evidence subject to that objection.

Mr. Teasdale: Excuse me, Mr. McRoberts. May I say I believe also that the defendant intends further to object, and would like to object at this time to any evidence offered by the plaintiff concerning the circumstances surrounding the acquisition of the stock and the sale of the stock, the attitudes concerning the minds of both parties involved in the lawsuit as to whether there was the ability to acquire inside information or not, and I think actually that our objection is somewhat broader than just how Emerson became interested in the stock, but covers the entire panorama of facts surrounding this transaction that are not contained in the stipulation, and I believe that that is somewhat broader than we have stated previously, so may we for the record, say that we object to all of this testimony, and with the understanding that Your Honor will overrule it, and we hope that this will perfect this objection for the record.

The Court: Well, if you understand I am going to overrule it, I think you are going beyond what I said. I said (12) I would hold in abeyance the ruling until after all the evidence is in, and then I'll make a determination at that time when I am required to write on this whether I sustain it or overrule it.

All right. Proceed.

Q. (By Mr. McRoberts) Mr. Persons, what kind of information did you have when you started your negotiations with Dodge? I am talking about the source of it, primarily? A. Well, Dodge is a public corporation. They

have printed annual reports for many years. They have submitted 10(k) and 8(k) reports to the SEC, which were available to us, and so we were able to gather a substantial record on this company from public information.

Q. Did you, at that time, have any information obtained from any inside source of Dodge, from any officer, director or employee of Dodge? A. None.

Q. And you carried on these negotiations over a period of several months, did you not, Mr. Persons? A. Almost a year.

Q. And your negotiations were primarily with the president of Dodge, Mr. J. Allan MacLean? A. They were.

Q. And did you finally appear before the Board of (13) Directors of Dodge? A. I did.

Q. And made a presentation to the Board? A. Made a presentation to the Board of a merger proposal.

Q. And that was, I believe, about February 28th, 1967, was it not? A. Yes. My original visit with Mr. MacLean was in April of 1966, and our presentation to their Board was in February.

Q. February 28th? A. Of 1967.

Q. And in due course were you advised by Mr. MacLean that the Dodge Board rejected Emerson's offer? A. I was.

Q. And what did Emerson do then following that rejection? Did you formally terminate negotiations? A. We did. We sent a telegram to the financial press and to Dodge announcing that we were terminating discussions.

Q. Is that document which has been identified as Plaintiff's Exhibit 1 a copy of that telegram? A. It is. It's a telegram signed by me to the Stock Exchange and the Financial Wire Services.

Q. Then for two months did Emerson have any further (14) contact with Dodge of any kind? A. None.

Q. And what happened on May 22, 1967, Mr. Persons? A. On May 22nd, which I believe was a Saturday, our directors met and considered the discussions which we had had with this company for many months past, and decided that we had made a very favorable offer to their

stockholders, which had been rejected for no clear reason by Dodge's board, and we therefore voted to extend a tender offer to the stockholders for 550,000 shares of their stock.

Q. And is Plaintiff's Exhibit 2 a copy of the offer for tender that you made? A. It is.

Q. And was that published in various financial papers and the public press generally? A. Yes, it was published in the Wall Street Journal, and it was published in various community papers where they thought that Dodge stockholders might be located.

Q. And is Plaintiff's Exhibit 3 a copy of one of those published offers for tender? A. It is.

Q. And was that thereafter extended, the original offer, extended by further publications, of which Plaintiff's Exhibit 4 is a copy? (15) A. It was extended, yes, and this exhibit is a notice in the financial press of extension until June 16th of that offer.

Q. And as soon as this offer was made on May 23rd, did you get any reaction from Dodge? A. Yes. Dodge, on May 23rd, announced to the financial community, through a release from Mishawaka that they urged their stockholders to reject that tender offer.

Q. Mishawaka is a suburb of South Bend? A. Yes.

Q. And that is where Dodge's plant and office is located? A. That is right.

Q. And subsequently did Mr. MacLean, on behalf of Dodge, write also to the stockholders of Dodge opposing the Emerson— A. Tender? Yes. These Exhibits 7 and 8 here are typical of letters which Mr. MacLean sent to the Dodge stockholders following that news release.

Q. And then what was the first time, approximately the first time that there was any public announcement of a proposal to merge Dodge and Reliance Electric? A. My record shows that that announcement took place on May 25th.

Q. And that was reported in the public press? A. It was reported in the public press, both the financial press in New York and in local papers.

(16) Q. And Exhibit 9 is a copy of one of such reports, is it not? A. Yes.

Q. And then did you next have a telephone communication from Mr. MacLean about some sort of litigation? A. Yes. I was advised on a Friday evening that—

The Court: What is the date?

The Witness: I beg your pardon. I'll consult my records, Your Honor, if I may. On Friday, May 26, I was advised by phone by Mr. MacLean that Dodge were filing suit the next day to enjoin us from accepting any tenders for Dodge stock; that his suit was to be filed in Judge Grant's office, the Northern District of Indiana, South Bend.

Q. And was such a suit filed, Mr. Persons? A. It was.

Q. And a copy of the restraining order served upon Emerson on Saturday night, late? A. Yes. Judge Grant issued a restraining order on May 27th, and it was served to one of Emerson's people on Saturday evening, May 27th.

Q. And following the filing of that suit, was there a hearing in South Bend, Indiana? A. There was. On June 2nd and 3rd.

Mr. McRoberts: Your Honor please, I have marked as (17) Exhibit 10 our file of that suit, and much of it may be irrelevant, but rather than pulling it apart—

The Court: Okay.

Mr. McRoberts: This contains a copy of the Complaint and certain of the proceedings in the case, and the final order and decision of the Court.

Q. (By Mr. McRoberts) In the course of that hearing, Mr. Persons, was a motion to cite Emerson for contempt filed? Do you recall that? A. There was, on the basis advertisements of the tender did appear in some cities on Monday.

Q. Who was handling the making and placing of these ads in the various newspapers? A. Those ads were being managed by the financial manager in New York, the G. H. Walker Company.

Q. I see. And you got the restraining order served

upon you sometime Saturday night, the 27th? A. Saturday evening, the 27th. I did not receive this personally, Mr. McRoberts. One of our people did at the plant.

Q. As a matter of fact, you arranged to have somebody stay out there at the gate at Emerson to accept that? A. I believe you did that.

Q. But all of the ads were not cancelled by Monday morning; is that correct? **(18)** A. Well, that was impossible. We got in touch with—attempted to get in touch with G. H. Walker, and I believe someone finally did late that evening, and they attempted to get in touch with the publications, and were unable to reach them. This was explained to the court.

Q. And then on June 8th the Court rendered its decision on the prayer for a temporary injunction, did it not? A. Yes.

Q. Mr. McRoberts: Without attempting, Your Honor, to state specifically what Emerson was charged with, that will appear from the Complaint in this case, among other things was Emerson charged by Dodge with using, taking advantage of confidential information that had been obtained in the course of your negotiations? A. It was.

Q. And was testimony offered on that subject before Judge Grant? A. It was.

Q. And, again, without attempting to quote the specific language of Judge Grant's finding, Your Honor, you will see that he found that Emerson had not obtained or made use of any confidential information.

Q. Now, Mr. Persons, upon the filing of this suit, on May 27th, Dodge advised its stockholders of the filing of that suit and sent letters to them, which Exhibits 11 and 12 **(19)** are copies, did they not? A. Yes.

Q. In the course of the trial of the suit, were you given permission to extend the tender offer, and did you so extend the tender offer? A. Following Judge Grant's decision lifting the—

Q. It was in the middle of the hearing Judge Grant said you could extend it because it was about to expire? A. My memory was not steady at that point. The tender

offer would have expired during the course of the suit, and Judge Grant did extend, because of that did extend it.

Q. And Exhibit No. 13 is a copy of the published notice of that extension, is it not? A. It was extended to June 16th, with Judge Grant's permission.

Q. Now, at about this time, the notices about Dodge's proposed merger with Reliance were being distributed to Dodge stockholders and in the public press, were they not? A. That is right. Their original announcement of the agreement in principle was dated May 25th, and then they circulated, following that, further advice about the proposed merger with Reliance.

Q. And the terms of the proposed merger were finally announced? A. Yes.

(20) Q. Then I am going to give you this copy just to refresh your recollection as to the date, Mr. Persons, and ask you whether or not on June 15th, 1967, at a special meeting of the Board of Directors of Emerson, the Board authorized the management to accept the shares of stock which had been tendered up to the close of business on June 16, 1967, and to its making an offer to merge with Dodge? A. Yes. I have in my hands the minutes of such a special directors' meeting held on June 15th, 1967.

Q. And then, without attempting to come in on each specific exhibit, between June 15th and June 22nd, were there further communications by Dodge to its stockholders, and by Emerson to Dodge, relating to the proposed Emerson merger and the proposed Dodge-Reliance merger, and are Exhibits 14 through 19 copies of such communications? A. Yes. I have here letters which Mr. MacLean sent to Dodge stockholders urging them to seriously consider and accept the Reliance Electric offer, and comparing it with the proposals which Emerson had made.

Q. There are also copies of Emerson's communications on the same subject? A. Yes. Emerson wrote to the Dodge Board, wrote to Mr. MacLean and proposed a merger arrangement, and that was acknowledged by Mr. MacLean.

Q. Mr. Persons, did Emerson have a copy of the (21) Dodge stockholders' list at that time? A. We did not.

Q. Was Dodge requested to furnish you with a copy of the list, or permit you to make a copy? A. Yes. On June 17th we requested a stockholders' list from them.

Q. Was that request denied or granted? A. It was acknowledged and denied.

Q. And did Emerson thereafter file a suit against Dodge in the state court of Indiana? A. On June 27th we filed suit.

Q. Seek— A. To secure such stockholders' lists.

Q. And is Plaintiff's Exhibit 20 a copy of your petition in that case, and the order which the court made directing the purchasing of such a list? A. It is.

Q. Then, Mr. Persons, your proposed merger with Dodge was finally put into formal shape, was it not? A. Yes.

Q. And transmitted to Mr. MacLean and the members of the Dodge Board by letter dated June 29th, of which Exhibit 21 is a copy? A. That is a copy of the proposal which we sent to all members of the Board of Directors.

(22) Q. And Exhibit 22 is the formal plan and agreement of merger itself that you sent to them, is it not? A. That is.

Q. And Exhibit 23 is Mr. MacLean's acknowledgment of that? A. Yes. This, in effect, is a letter from Mr. MacLean rejecting our proposal.

Q. Acknowledges receipt of it? A. Receipt of it.

Q. Following that, Mr. Persons, did Dodge and did Emerson and Reliance engage in a proxy contest, seeking to get the Dodge stockholders to vote for their respective plans of merger? A. We did.

Q. And in the course of that contest, did Emerson file another suit in the Federal Court at South Bend, Indiana, against Dodge Manufacturing Company and its directors? A. We did on July 17th.

Q. And Exhibit 25 is a copy of the original Complaint in that case, and certain of the pleadings, and the final order that was entered in this case, is it not? A. Requesting correction of false statements in connection with the Emerson merger.

Q. And without trying to quote precisely what the Complaint says, you were charging Dodge and the officers with (23) making false and misleading statements about the Emerson proposal, and about the Reliance proposal? A. Right.

Q. And in the course of that proxy, the Court denied you the relief that you prayed for in that case, did they not? A. Yes.

Q. And an appeal was taken to the Seventh Circuit Court of Appeals? A. Yes.

Q. And in the course of that proxy contest, during that pendency of that litigation and thereafter, were various communications sent by Emerson and by Dodge to the Dodge stockholders, of which Exhibits 24 through 30 are copies? A. Yes. Both sides sent communications in support of its particular views.

Q. And the Dodge stockholders' meeting was held, I believe, on August 22nd, 1967? A. Yes.

Q. At which time the Dodge stockholders voted substantially in favor of the Reliance merger, did they not? A. That is true.

Mr. McRoberts: It is stipulated, if Your Honor please, in the stipulation that Emerson's counsel, our firm, sent certain communications to Emerson commenting upon (24) Section 16(b) and the threat of it, and various steps which might be taken to avoid it, and it is also stipulated that on August 28th, 1967, following discussions which had been carried on for several days before that over the telephone, Mr. Davis the president of Emerson—Mr. Persons was out of the country at the time—Mr. Davis, the president of Emerson, and Mr. Tenanbaum of Goldman, Sachs, agreed that Emerson would sell and Goldman, Sachs would purchase 37,000 shares of Dodge stock; that on August 29th those shares were delivered by Emerson to the local office of Goldman, Sachs, and were paid for a few days thereafter by Goldman, Sachs. It is also stipulated that on August 29th Mr. Rose, counsel for Reliance, of the Jones, Day, Cockley & Reavis firm, telephoned me, and following that telephone call on September 15th, 1968,

Mr. Rose and I agreed that Emerson would sell and Dodge would agree to purchase the remaining 115,282 shares of Dodge stock held by Emerson, subject to the negotiations of a definitive agreement of sale; that thereafter negotiations toward such an agreement were carried on, and on the 11th of September, such a purchase agreement was entered into, a copy of which is attached to the stipulation, and that at the time certain letters were exchanged by counsel expressing certain opinions and giving certain advice with respect to the effect of the transaction, which are attached to the stipulation.

(25) I am withdrawing Exhibit 32, Miss Rahn, because that is already a part of the stipulation.

Thereafter, if Your Honor please, Reliance proposed to acquire the Toledo Scale Corporation, and in that connection put out a proxy statement, a copy of which has been identified as Plaintiff's Exhibit 33. And I offer that in evidence in directing the Court's attention solely to the statement under the caption "General Information" appearing on page 37 and 38, which refers to the transactions whereby Emerson acquired and disposed of these shares of stock of Dodge.

Mr. Persons, prior to the acquisition by Emerson of the 152,252 shares of stock on June 16, 1967, did Emerson own any stock, common stock, or any other securities of Dodge Manufacturing Company? A. None.

Q. Or at any time thereafter, except that same 152,282 shares? A. No, we did not.

Q. Now, except for the dealings with Dodge, as shown in the documents offered in evidence here, and the one telephone call which Mr. MacLean made to you on Friday, May 26th, did you, or to the best of your knowledge, information and belief, did anyone on behalf of Emerson have any personal dealings or communications with Dodge, or any of the officers of Dodge? **(26)** A. No. Mr. MacLean and I agreed at the beginning of our conversations in 1966 that we would—

Q. I am talking about— A. Excuse me.

Q. I am talking about the time after you purchased the shares? A. No.

Q. And during all of this proxy contest, and this litigation, and so forth? A. No, Mr. McRoberts, we had no communication.

Q. And did you, at any time after the trial, before Judge Grant and after he rendered his decision on June 8th, 1967, obtain any information with respect to the affairs of Dodge, the business, the property of Dodge, the activities of Dodge, other than public information which was available to all stockholders? A. None.

Mr. McRoberts: That is all.

Mr. Teasdale: Your Honor, could we have a short recess?

The Court: All right.

Mr. McRoberts: To complete the record, I might offer in evidence, if Your Honor please, the various exhibits which have been identified and been offered, excepting 32, which (27) was marked but is a duplication, and that is the only exception.

The Court: All right. All exhibits that have been offered, save Exhibit No. 32, will be received.

Court will have a temporary recess.

(Following a brief recess, the further following proceedings were had:)

Mr. Teasdale: Your Honor, at this time—shortly before the recess Mr. McRoberts offered certain documentary evidence into the record. Though we are late, we would request the Court's permission to renew our objection that these documents are immaterial.

The Court: You mean all, with the exception of 32?

Mr. Teasdale: Yes, Your Honor. All, with the exception of 32, on the grounds that intent and the ability to actually get inside information is irrelevant in 16(b) questions.

The Court: Well, I will take it subject to that.

Mr. Teasdale: Thank you, Your Honor. And we have no cross-examination.

(Witness excused.)

Mr. McRoberts: Your Honor please, we would like a short time to file a memorandum, and perhaps two weeks—

The Court: Thirty days.

Mr. McRoberts: Two weeks will be plenty.

(28) Mr. Teasdale: Your Honor—

The Court: I am sure you want at least two weeks to reply, and they will want five days, so plaintiffs given fourteen days to file their briefs and suggested Findings of Facts and Conclusions of Law. Defendants given, and counterclaimants are given— you have a counterclaim in here, don't you?

Mr. Teasdale: Yes, we do, Your Honor.

The Court: What about that?

Mr. Teasdale: The counterclaim is essentially the reverse of the request for declaratory judgment.

The Court: All right. They have fourteen days in which to reply, and then the plaintiffs will have five days thereafter. On the filing of the last brief, the matter will be taken as submitted.

Mr. Walsh: Your Honor, may we have leave to withdraw the original exhibits for the purposes of copying?

The Court: You may.

Mr. Teasdale: Your Honor, has the stipulation been officially filed and received by the Court?

The Court: I took it—it was not marked as an exhibit, but it was filed. I thought it was by consent that it was being submitted.

Mr. Teasdale: It is by consent, Your Honor.

The Court: It will be received.

Mr. Teasdale: We have nothing else. Thank you **(29)** Your Honor.

(Certificate of reporter omitted in printing.)

PLAINTIFF'S EXHIBIT 1.

(Western Union Telegram)

March 22, 1967

New York Stock Exchange
11 Wall Street
New York, N. Y.

Midwest Stock Exchange
120 S. La Salle Street
Chicago, Illinois

Dow Jones Ticker Service
44 Broad Street
New York, N. Y.

Following a meeting of the Board of Directors of Emerson Electric Co. today, the following statement was issued with respect to the company's merger negotiations with the Dodge Manufacturing Corporation, Mishawaka, Indiana:

After many months of friendly negotiations, Emerson Electric Co. on February 28, 1967 made to the Dodge Board of Directors its final proposal to acquire, on a tax-free basis to Dodge stockholders, the business and assets of Dodge in exchange for shares of Emerson stock. Emerson's offer has been rejected by the Dodge Directors and Emerson's Board of Directors today voted to formally withdraw such offer and to formally terminate all negotiations with Dodge Manufacturing Corporation.

W. R. Persons, Chairman
Emerson Electric Co.

PLAINTIFF'S EXHIBIT 3.

The Wall Street Journal
Wednesday, May 24, 1967

Offer to Purchase
550,000 Shares of Common Stock of
Dodge Manufacturing Corporation
at $63 per Share

Emerson Electric Co. hereby invites tenders of 550,000 shares of Common Stock of Dodge Manufacturing Corporation for purchase at $63 per share, net to the selling stockholder pursuant to the terms and conditions set forth in the Offer Letter dated May 22, 1967, and the letter of Transmittal. The closing price of Dodge Manufacturing Corporation Common Stock on the New York Stock Exchange on Friday, May 19, 1967, the last trading date prior to the announcement of the offer was $44.75.

The offer will terminate at 5:00 P. M., Chicago time, on June 2, 1967, unless extended.

All shares up to 550,000 shares tendered before the offer expires will be purchased provided at least 460,000 shares are tendered. If less than 460,000 shares are tendered, none or all or a portion of the shares tendered may be purchased. If more than 550,000 shares are tendered, none or all or a portion of the excess shares may be purchased. If less than all shares tendered up to June 2, 1967 are purchased, they will be purchased on a pro rata basis. If the offer is extended and less than all shares tendered during the extended period are purchased, they will be purchased in the order received by the Co-Depositaries.

Copies of the Offer Letter and Letter of Transmittal may be obtained through any broker or bank or from

First National Bank of Chicago
38 South Dearborn Street
Chicago, Illinois 60690
(312) SH 3-1353

Marine Midland Grace Trust
Company of New York
140 Broadway
New York, N. Y. 10015
(212) 797-8200

G. H. Walker & Co.
Room #2057
208 South La Salle Street
Chicago, Ill. 60604
(312) 782-0551

St. Louis Union Trust Co.
510 Locust Street
St. Louis, Mo. 63101
(314) CE 1-9300

G. H. Walker & Co.
Broadway and Locust
St. Louis, Mo. 63101
(314) CE 1-3000

Scherck, Stein & Franc, Inc.
408 Olive Street
St. Louis, Missouri 63102
(314) GA 1-0225

Emerson Electric has retained G. H. Walker & Co. and Scherck, Stein & Franc, Inc. to act as Dealer-Managers to solicit tenders through securities dealers. Any member of a national securities exchange or of the National Association of Securities Dealers, Inc. (or any foreign dealer not eligible for membership in such Association who has agreed to conform to the Rules of Fair Practice of such Association) which has solicited and obtained the tender of shares and whose name appears on the Letter of Transmittal accompanying said shares will receive a fee of 90¢ for each share purchased under this offer.

G. H. Walker & Co. Scherck, Stein & Franc, Inc.
May 22, 1967

— Use coupon below to obtain Letter of Transmittal —

(Send to G. H. Walker & Co., Scherck, Stein & Franc, Inc., or any of the above named Co-Depositaries.)

Please send _____ copies of the Emerson Electric Co. Offer to Purchase shares of Dodge Manufacturing Corporation and Letter of Transmittal.

Name _____

Address _____

City _____ State _____ Zip _____

PLAINTIFF'S EXHIBIT 4.

Offer to Purchase
550,000 Shares of Common Stock of
Dodge Manufacturing Corporation
at $63 per Share
has been extended until June 16, 1967

This extension is being made in accordance with the original Offer to Purchase, dated May 22, 1967. Emerson Electric invites tenders of 550,000 shares of Common Stock of Dodge Manufacturing Corporation for purchase at $63 per share, net to the selling stockholder, pursuant to the terms and conditions set forth in the Offer Letter, dated May 22, 1967, and the Letter of Transmittal.

The offer will terminate at 5:00 p. m., Chicago Time, on June 16, 1967, unless extended.

A restraining order which prohibited the acceptance of shares tendered was dissolved by the United States District Court for the Northern District of Indiana on June 8, 1967, Emerson Electric Co. is free to accept all shares tendered in accordance with the terms of its offer.

All shares up to 550,000 shares tendered before the offer expires will be purchased provided at least 460,000 shares are tendered. If less than 460,000 shares are tendered, none or all or a portion of the shares tendered may be purchased. If more than 550,000 are tendered, none or all or a portion of the excess shares may be purchased.

If less than all shares tendered by 5:00 p.m., Chicago Time, June 16, 1967, are to be purchased, such shares will be selected, first from among those shares validly tendered to and including June 2, 1967, and next, from among the shares validly tendered on and after June 5, 1967 in the order received by the Co-Depositaries.

Copies of the Offer Letter and Letter of Transmittal may be obtained through any broker or bank or from

First National Bank of Chicago
38 South Dearborn Street
Chicago, Ill. 60690
(312) FR 2-6800

Marine Midland Grace Trust
Company of New York
140 Broadway
New York, N. Y. 10015
(212) 797-8200

G. H. Walker & Co.
Room #1054
203 South La Salle Street
Chicago, Ill. 60604
(312) 782-0551

St. Louis Union Trust Co.
510 Locust Street
St. Louis, Mo. 63101
(314) CE 1-9800

G. H. Walker & Co.
Broadway and Locust
St. Louis, Mo. 63101
(314) CE 1-3000

Scherck, Stein & Franc, Inc.
408 Olive Street
St. Louis, Mo. 63102
(314) GA 1-0225

Emerson Electric Co. has retained G. H. Walker & Co. and Scherck, Stein & Franc, Inc., to act as Dealer-Managers to solicit tenders through securities dealers. Any member of a national securities exchange or of the National Association of Securities Dealers, Inc. (or any foreign dealer not eligible for membership in such Association who has agreed to conform to the Rules of Fair Practice of such Association) which has solicited and obtained the tender of shares and whose name appears on the Letter of Transmittal accompanying said shares will receive a fee of 90c for each share purchased under this offer.

G. H. Walker & Co. Scherck, Stein & Franc, Inc.

June 12, 1967

PLAINTIFF'S EXHIBIT 5.

St. Louis Post-Dispatch
Tuesday—May 23, 1967

Business News

Dodge to Advise Rejection of Bid

Special to the Post-Dispatch

Mishawaka, Ind., May 23—The board of directors of Dodge Manufacturing Corp. will counsel its shareholders not to accept a tender offer of $63 per share of common stock as proposed by the Emerson Electric Co. of St. Louis, Mo.

J. Allan MacLean, Dodge president, said a special meeting of the board was called Monday afternoon to consider the planned Emerson tender offer which was reported unexpectedly in newspapers Monday.

Although the Dodge board has no information to indicate when the Emerson offer actually will be made, MacLean said, the directors are convinced that the price to be offered is too low and should not be accepted by Dodge shareholders. He pointed out that capital gains realized through such a transaction would be subject to federal tax.

In recommending rejection of the tender offer at this price, the directors said they took into account the fact that annual sales of Dodge products for the last fiscal year were up 80 per cent over five years ago and that earnings were 170 per cent higher. Dividends have increased from 75 cents to $1.80 per share on an annual basis, and the market price of Dodge common stock has tripled since 1961.

Currently, the Dodge management said, it is actively exploring two tax-free merger possibilities and it has several acquisitions under active consideration as well.

PLAINTIFF'S EXHIBIT 6.

The Wall Street Journal
Tuesday—May 23, 1967

Dodge Mfg. Directors Urge Holders to Reject Emerson Electric Offer

---

By a Wall Street Journal Staff Reporter

Chicago—Directors of Dodge Mfg. Corp. last night urged shareholders to reject a proposed tender offer from Emerson Electric Co., St. Louis, of $63 a share for Dodge stock.

In trading on the New York Stock Exchange yesterday, Dodge stock leaped to $61 a share, up $16.25 from Friday's close.

Emerson Electric disclosed its plans for the offer over the weekend. J. Allan MacLean, Dodge president, said after the meeting of Dodge directors yesterday that the Dodge board is convinced the price is too low and should be rejected by shareholders.

He said that capital gains realized through such a transaction would be subject to Federal tax.

In taking its position, the Dodge board said that annual sales of Dodge products in its latest fiscal year were up 80% over five years ago and that earnings were up 170% in the same span. Dividends have risen to $1.80 a share annually from 75 cents a share five years ago, directors said.

Sunday night, Dodge said that it has resumed preliminary merger talks with several companies and that it was continuing acquisition talks with some smaller concerns. Last night, Dodge said it was exploring two tax-free merger possibilities and several acquisitions.

Dodge said that since it was confident the company's progress will continue it would discourage the tender offer.

Emerson had previously submitted a merger proposal to Dodge directors on Feb. 28, but those talks were later broken off.

In its latest offer, Emerson said it was seeking up to 550,000 Dodge shares. Emerson said that the offer was contingent on at least 460,000 Dodge shares being tendered but that Emerson reserved the right to purchase all shares, regardless of the number being tendered. If Emerson were to receive 550,000 Dodge shares at $63 each, the value of the transaction would be $34,650,000. Dodge had 1,114,482 shares outstanding as of March 31.

Dodge, a Mishawaka, Ind., maker of bearings, drives, couplings and other devices for power transmission equipment, in the third quarter ended March 31, earned $970,784, or 84 cents a share, on sales of $11,172,003.

PLAINTIFF'S EXHIBIT 7.

Dodge Manufacturing Corporation
Mishawaka, Indiana
May 24, 1967

Executive Offices

To All Dodge Shareholders:

A St. Louis concern, Emerson Electric Co., has issued a tender offer for 550,000 shares of Dodge common stock. We strongly urge you **not to accept** this offer: it is too low. It has been made on a straight "pro rata" basis—not first come, first served—which means that there is absolutely no benefit to you in accepting the offer at this time.

Your Board of Directors met Monday, May 22, to discuss the Emerson proposal. It considered these facts:

A tax-free exchange of stock would be better for our stockholders: the Emerson offer of $63 would involve capital gains tax

Several major companies have approached us for a tax-free merger; we are actively negotiating with two of them

The directors are confident that we can develop a more attractive **tax-free** proposal

In urging that you not accept this offer now, the directors also emphasize these facts:

Dodge sales for fiscal 1966 were up 80% over those of five years ago

Earnings were 170% higher in the same period

Dividends have increased from 75 cents to $1.80 per share on an annual basis

The market value of your stock has tripled since 1961

The long-term future of Dodge looks very good indeed

The Dodge directors will meet again shortly, to further evaluate various proposals, and we will send you the Board's recommendations before the June 2 expiration date of the Emerson offer.

We therefore urge that you **not tender** your stock at this time. **No director or officer will tender** any stock. Please await further recommendations from the directors.

Sincerely yours,

By Order of the Board of Directors

/s/ J. A. MacLean

J. A. MacLean

President

PLAINTIFF'S EXHIBIT 8.

Dodge Manufacturing Corporation
Mishawaka, Indiana
May 25, 1967

To All Dodge Shareholders:

The attached statement regarding a Dodge merger with The Reliance Electric and Engineering Company was released to the news services and the financial community this afternoon. As I assured you yesterday, we are reporting this to you immediately. It has the strong support of the directors of your company and presents an extremely attractive tax-free merger proposal.

Your Dodge directors recommend this proposal to you without qualification. The managements are proceeding at once with the preparation of the formal merger agreement, which will be presented to shareholders for approval.

You are urged to adopt the recommendation of the Dodge Board and to refrain from taking any action with respect to the recent tender offer.

Sincerely yours,

By Order of the Board of Directors
/s/ J. A. MacLean
J. A. MacLean
President

Enclosure

STATEMENT RELEASED TO THE PRESS BY
DODGE MANUFACTURING CORPORATION
MAY 25, 1967

The Reliance Electric and Engineering Company, Cleveland, Ohio, and Dodge Manufacturing Corporation, Mishawaka, Indiana, have reached an agreement in principle for the merger of Dodge into Reliance, it was announced jointly today by Hugh D. Luke, president of Reliance, and J. Allan MacLean, president of Dodge.

Tentative approval of the proposal was given by the Dodge directors at a special meeting in Mishawaka this afternoon.

The agreement calls for each Dodge share to be exchanged for one share of new cumulative convertible preferred stock of Reliance which would carry a $2.50 annual dividend rate, be convertible into 1.4 shares of Reliance common stock, be non-callable for 5 years, and callable thereafter at $70 per share. The merger would be a tax-free transaction for Federal income tax purposes.

Mr. MacLean said today that the proposed merger would be in the best interests of the Dodge shareholder, as it was a tax-free transaction, and would result in Dodge shareholders receiving securities having greater value than the recent cash tender offer of $63, which would be taxable. The $2.50 dividend rate on the new preferred shares would be $.70 above the $1.80 annual rate presently paid on Dodge shares.

The formal merger agreement would be subject to approval of the boards of directors of both companies, and would also require approval of shareholders of both companies.

Reliance manufactures electric motors, generators, Master gearmotors, Reeves drives, all-electric adjustable speed drives, etc., with plants in Cleveland and Ashtabula, Ohio, and Columbus and Madison, Indiana.

Reliance reported net sales of $118,935,000 for fiscal 1966, and net earnings of $7,902,000, equal to $2.69 per share on 2,936,105 shares of common stock outstanding October 31, 1966.

Dodge, which manufactures mechanical power transmission equipment, reported net sales of $42,936,000 in fiscal 1966, and earnings of $4,004,000, equal to $3.52 a share on 1,137,182 common shares outstanding June 30, 1966.

PLAINTIFF'S EXHIBIT 9.

St. Louis Post-Dispatch
Friday—May 26, 1967

Business News
Finance * Industry
Reliance, Dodge Agree to Merge

Cleveland, O. (AP) — A merger agreement has been reached by Reliance Electric Co., Cleveland and Dodge Manufacturing Corp., Mishawaka, Ind., with Reliance as the surviving firm, officials of the two companies announced yesterday.

The agreement calls for each share of Dodge stock to be exchanged for one share of a new cumulative, convertible preferred stock of Reliance which would carry a $2.50 annual dividend rate. The new stock would be convertible into 1.4 shares of Reliance common stock, be noncallable for five years and be callable thereafter at $70 a share.

J. Allan MacLean, president of Dodge, said the merger would be a tax-free transaction and would result in Dodge shareholders receiving securities having greater value than the recent Emerson Electric Company's cash tender of $63 which would be taxable.

The merger agreement is subject to approval of the directors and shareholders of both companies.

Emerson today said the Reliance offer amounted to $51 a share of Dodge stock. Reliance closed yesterday at $37 a share.

Today, however, Reliance Electric sold at about $40 a share.

Emerson for the first time revealed the terms of its offer on Feb. 28 to merge with Dodge. "Emerson offered Dodge an exchange of stock merger proposal having a value of $62.50 per Dodge share. Dodge directors refused Emerson's offer and demanded $72 per share for Dodge," the statement said.

"Why was Emerson's prior offer to merge kept from Dodge stockholders?" Emerson asked. It said it was continuing to offer $63 a share for Dodge stock.

PLAINTIFF'S EXHIBIT 10.

Civil Action No. 4023.

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF INDIANA
SOUTH BEND DIVISION

Dodge Manufacturing Corporation, 500 South Union Street, Mishawaka, Indiana, an Indiana corporation,

Temple Williams, 910 Lincoln Way East, Mishawaka, Indiana,

John R. Wood, Jr., 3002 Robinhood Lane, South Bend, Indiana,

Plaintiffs,

v.

Emerson Electric Co., a Missouri Corporation,

Defendant.

VERIFIED COMPLAINT

Plaintiffs allege as follows:

1. The jurisdiction of this Court to hear this Complaint is based upon the original and exclusive jurisdiction of the Court in respect of violations of the Securities Exchange Act of 1934, as amended (The "Act"), 15 U. S. C., §§ 78a-78jj, or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by said Act or the rules and regulations thereunder. 15 U. S. C., § 78aa. This controversy involves, inter alia, § 10 of the Act (15 U. S. C., § 78j) and Reg., § 240.10b-5 ("Rule 10b-5") promulgated by the Securities and Exchange Commission thereunder.

2. Plaintiff Dodge Manufacturing Corporation ("Dodge") is an Indiana corporation with principal offices located in Mishawaka, Indiana. Dodge has been and is being subjected to continued harassment by Defendant, and seeks the relief herein prayed for to permit

it to act in the best interests of the Corporation and its shareholders and to protect their rights as hereinafter set forth. Plaintiffs Temple Williams and John R. Wood, Jr. own, respectively, 2400 and 1000 shares of the common stock of a par value of $2.50 per share, of Dodge. Plaintiffs other than Dodge bring this action for themselves and as a class pursuant to Rule 23, Federal Rules of Civil Procedure, in behalf of all owners of shares of such common stock ("Dodge Common").

3. Defendant Emerson Electric Co. ("Emerson") is a Missouri corporation with executive offices located in St. Louis, Missouri and is engaged in the business of manufacturing electrical and electronic products, systems and controls for industrial, commercial and other applications.

4. Dodge, which has its executive offices at 500 South Union Street, Mishawaka, Indiana, is a manufacturer of mechanical power transmission equipment. It was incorporated in the State of Indiana in 1935, and since that time has maintained its executive offices and major manufacturing facilities in Mishawaka, Indiana. For the fiscal year ended June 30, 1966, its net sales were $42,936,150, and its net income was $4,004,149. At January 30, 1967 there were 1,144,062 shares of Dodge Common outstanding and Dodge had more than 3100 shareholders, over 38% of whom were small shareholders owning less than 100 shares each. More than 38% of the shares were held by residents of Indiana and they owned, in the aggregate, nearly 410,652 shares of Dodge Common at that date.

5. (a) On Sunday, May 21, 1967, Emerson's shareholders, without any notice to the officers or directors of Dodge, issued a press release to *The Wall Street Journal*, a newspaper printed and having substantial circulation in the Northern District of Indiana, announcing, among other things, that it "plans to make a tender of $63 a share to holders of Dodge Mfg. Co., Mishawaka, Ind. for up to 550,000 Dodge shares," and said press release further stated that it was the "full intention to maintain Dodge

operations at the present Mishawaka-South Bend location and to continue company's current policies, practices and employment." Said news release was published in the Monday, May 22, 1967 edition of *The Wall Street Journal.*

(b) On May 24, 1956 and again on May 26, 1967, Emerson caused to be published in the *Chicago Tribune,* received by many persons in the Northern District of Indiana, a document styled "Offer to Purchase" for the purpose of attempting to obtain controlling interest of Dodge. A copy of said "Offer to Purchase" as it appeared in said *Chicago Tribune* on May 24, 1967 is attached hereto and made a part hereof. On May 23, 1967 Emerson issued a press release in which it stated that "we are interested in Dodge as a long term investment."

(c) Emerson caused to be published on May 24, 1967 and on May 26, 1967 in the Midwest Edition of *The Wall Street Journal* a document which purports to be identical to the "Offer to Purchase" referred to in Paragraph 5(b) hereof.

6. As hereinafter set forth, the statements of Emerson quoted or referred to in Paragraphs 5(a), (b) and (c) hereof are in violation of § 10 of the Act and of Rule 10b-5. For example,

(a) In April of 1966 the officers of Emerson approached the officers of Dodge for the purpose of initiating negotiations for the merger of the two corporations; thereafter, and especially during the months of August, 1966, through March of 1967, the officers of Emerson and the officers of Dodge, individually and/or collectively, met on numerous occasions to determine whether or not they could negotiate an arrangement whereby Emerson would acquire all or substantially all of the Dodge Common. During these meetings and negotiations, Emerson repeatedly made the positive assertion and representation that under no circumstances would Emerson ever make a tender offer to the shareholders of Dodge. Such representation was reaffirmed by Emerson as recently as May 16, 1967. In reliance on these repeated assertions and representations,

the officers and directors of Dodge permitted Emerson to have access to and thorough knowledge of Dodge manufacturing techniques and procedures, Dodge engineering, developmental and design facilities and techniques, Dodge sales data and distribution policies, procedures and philosophy, Dodge financial structure, and Dodge policies for motivation of employees throughout the organization from top management down. This latter includes incentive programs, deferred compensation, stock option plans, etc., which Dodge management considers essential in securing maximum employee performance and efficiency. Said negotiations terminated during the latter part of the month of February, 1967, when the officers of Dodge determined that the proposal by Emerson was inadequate; the officers of Dodge then submitted a counterproposal to Emerson which was rejected by Emerson; thereafter, Emerson requested the opportunity to appear before the Board of Directors of Dodge at a special meeting called for the purpose of re-submitting its earlier offer directly to the Board of Directors of Dodge. Such a meeting of the Board of Directors of Dodge was called and held on February 28, 1967, at which meeting all of the directors of Dodge were present with the sole exception of S. B. Hainsworth, who was then in England. Emerson did re-submit its proposal for the acquisition of the stock of Dodge directly to the Board of Directors and, after lengthy deliberations, the Board of Directors of Dodge on March 12, 1967 rejected the proposal of Emerson without a dissenting vote. Thereafter, as set forth in Paragraphs 5(a), (b) and (c) hereof, and in contradiction to its repeated assertions and representations, Emerson did make a tender offer to the shareholders of Dodge.

By virtue of its assertions and representations set forth above, Emerson obtained from Dodge confidential information of a nature customarily restricted to officers and directors of Dodge and not normally available otherwise. Emerson's tender offer to the Dodge shareholders is undoubtedly based upon such confidential information not disclosed by it in the offer.

(b) Emerson omitted to disclose the material facts relating to the amount of money which would be required to be borrowed by it in order to purchase 550,000 shares of Dodge Common at the offer price, and that its reasonably anticipated interest cost would be approximately twice its reasonably anticipated dividend yield from such shares. Ordinary standards of business prudence make it impossible to reconcile such facts with the statements of Emerson quoted or referred to in Paragraphs 5(a), (b) and (c) hereof.

(c) Notwithstanding Emerson's statement in its press release quoted in Paragraph 5(a) hereof to the effect that it has full intention to "maintain Dodge operations at the present Mishawaka-South Bend location and to continue company's current policies, practices and employment," on March 23, 1967, Emerson made the following derogatory statement about Dodge management to *The Wall Street Journal:* "It is regrettable that Dodge management did not see fit to give Dodge shareholders an opportunity to accept or reject what we felt was an attractive offer." Emerson has made equally derogatory remarks as hereinafter set forth in Paragraph 8(d). As a result of the conflicting and ambiguous statements of Emerson set forth above, Emerson has omitted to state categorically what its true policy will be with respect to the present Dodge management if Emerson acquires controlling interest of Dodge.

7. The "Offer to Purchase" and the press release set forth in Paragraph 5(a) further violate § 10 of the Act and Rule 10b-5 in at least the following respects:

(a) Emerson omitted to state the number of shares of Dodge which it presently owns, the extent to which it has acquired or is acquiring or is now negotiating to acquire or intends to acquire, shares of Dodge other than pursuant to the Offer to Purchaser, and whether it has any present plan or intention of making any other offer at the stated price or any other price per share or on any other terms or conditions.

(b) The Offer to Purchase in May 24, 1967 and May 26, 1967 Midwest Edition of *The Wall Street Journal* and the May 24, 1967 and May 26, 1967 editions of the *Chicago Tribune* states that the closing price on May 19, 1967 of Dodge Common on the New York Stock Exchange was $44.75. Such Offer to Purchase fails to state (i) that on May 22, 1967 and May 23, 1967, and prior to the publication by Emerson of its Offer to Purchase in the form carried in *The Wall Street Journal* and the *Chicago Tribune* as above stated, the price of Dodge Common on the New York Stock Exchange had already reached a price in excess of $60 per share (although Emerson had adequate time within which to ascertain and publish such prices); (ii) that there had been prior merger negotiations between Emerson and Dodge which had been terminated when Dodge declined to recommend to its shareholders the previous offer made by Emerson which, in the opinion of the Board of Directors of Dodge, was inadequate; all of which is material in forming a prudent investment judgment with respect to the Offer to Purchase.

(c) The Offer to Purchase by its terms expires on June 2, 1967, thereby giving Dodge shareholders, at most, seven (7) business days within which to decide whether to sell their shares; and even then the shareholders must first obtain a Letter Offer and a Letter of Transmittal from a broker or bank designated by Emerson. This arbitrary and unreasonably short space of time is wholly inadequate to permit shareholders to make an informed judgment as to whether or not to tender their shares.

8. Unless restrained by this Court, such action by Emerson, as set forth herein, will result in irreparable loss and damage to Dodge and its shareholders in that:

(a) The officers and directors of Dodge are and will be effectively prevented by Emerson in exercising their fiduciary responsibilities to the shareholders of Dodge in an independent manner free from coercive restraints imposed by Emerson, including the consideration of proposals of merger from other national corporations.

(b) The shareholders of Dodge are and will be effectively prevented from exercising their best judgment with respect to the disposition of their shareholdings unless and until the officers and directors of Dodge are permitted to advise them in detail with respect to the tender of offer made by Emerson, together with information pertaining to any proposed mergers, which, in the opinion of the officers and directors of Dodge, should be presented to the shareholders.

(c) Dodge has reached an agreement in principle for the merger of Dodge into Reliance Electric and Engineering Company, of Cleveland, Ohio, which is and will be jeopardized by the aforementioned action of Emerson.

(d) Emerson continues to issue statements to the press characterizing and commenting upon the action of the Board of Directors of Dodge as set forth in Paragraph 6(c) above and as set forth in the news release issued by Emerson on Friday, May 26, 1967, to wit:

> "The Dodge Directors are taking steps toward breaking the status quo of Dodge as an independent manufacturer. However, their position on values of Dodge shares was an astounding change. On February 28, Emerson offered Dodge an exchange of stock merger proposal having a value of $62.50 per Dodge share. Dodge directors refused Emerson's proposal and demanded $72 per share for Dodge.
>
> We have not had an opportunity to study Reliance offer in detail. However, assuming that the 58 million exchange price was released by Dodge, this, divided by the 1,137,182 shares stated as outstanding, would show a value of $51 per Dodge share.
>
> Emerson must now ask what lies behind the Dodge directors change of position on values. Why was the Emerson prior offer to merge kept from Dodge stockholders?
>
> We feel the Emerson tender offer of $63 is most generous to Dodge shareholders and we are continuing the offer."

Wherefore, Plaintiffs Pray,

1. That the Court issue a temporary restraining order and preliminary injunction enjoining Defendant Emerson, its officers, agents, servants, employees and attorneys, and all persons in active concert or participation with them who receive actual notice of said injunction by personal service or otherwise, from:

(a) Taking any action in connection with the Offer to Purchase, including accepting any tenders in response to the Offer to Purchase received after issuance of a temporary restraining order or other order of the Court;

(b) Failing, forthwith upon the issuance of such temporary restraining order or other order of the Court, to offer, to all persons who shall have tendered shares of stock of Plaintiff Dodge pursuant to the Offer to Purchase, the right to rescind such tenders without penalty;

(c) Failing to return any stock certificates received in response to the Offer to Purchase after issuance of such temporary restraining order or other order of the Court;

(d) Until further order of the Court, renewing the Offer to Purchase or making any other offer to purchase shares of stock of Dodge.

2. That following a hearing on the merits of this case, the Offer to Purchase be held invalid, and the Court issue an injunction enjoining Defendant Emerson, its officers, agents, servants, employees and attorneys, and all persons in active concert or participation with them who receive actual notice of said injunction by personal service or otherwise, from:

(a) Taking any action in connection with the Offer to Purchase, including accepting any tenders in response to the Offer to Purchase;

(b) Failing to return any stock certificates received in response to the Offer to Purchase;

(c) Renewing the Offer to Purchase or making any other general offer to purchase Dodge shares unless said offer is made fairly and reasonably as among the various shareholders of Dodge, and includes complete disclosure of:

(1) The method of financing, including the amount, source and each material term and condition of such financing used or to be used in order to carry out the proposed purchases of shares of stock of Dodge;

(2) Defendant's most recent annual report to shareholders, including financial statements contained therein;

(3) A pro forma balance sheet of Defendant as of the most recent date for which figures are available, giving effect to its proposed acquisition of Dodge shares;

(4) Plans of Defendant with respect to the number, membership and activities of the Board of Directors of Dodge and the Executive Committee thereof;

(5) Plans of Defendant with respect to any changes in the number, identity, activities, responsibilities and authority of the officers of Dodge;

(6) Plans, agreements or understandings of Defendant with respect to reorganizations or rearrangements involving or affecting the business, property, affairs or corporate organization of Dodge or respecting any acquisitions by Dodge;

(7) Each other material fact necessary in order to make the statements made (or to be made) in said offer under the circumstances under which they were or are made not misleading.

3. That the Court award Plaintiffs reasonable attorneys' fees and their costs and disbursements herein.

4. That the Court grant Plaintiffs such other and further relief as may be just and proper in the circumstances.

Oare, Thornburg, McGill & Deahl
By Edward J. Gray
By Franklin A. Morse II
645 First Bank Building
South Bend, Indiana

Of Counsel:

Hopkins, Sutter, Owen, Mulroy, Wentz & Davis
One North LaSalle Street
Chicago, Illinois

State of Indiana)
St. Joseph County) ss.

J. Allan MacLean, being first duly sworn, deposes and says that he is the President and chief executive officer of Dodge Manufacturing Corporation, one of the Plaintiffs in the within action; that he has read the foregoing Complaint; that the allegations and statements therein are true; that he is authorized by Dodge Manufacturing Corporation so to state, and that he makes this statement for and on behalf of Dodge Manufacturing Corporation and is authorized by it so to do.

/s/ J. Allan MacLean
J. Allan MacLean

Subscribed and sworn to before me this ___ day of May, 1967.

Notary Public

My commission expires: _____

Civil Action No. 4023.

IN THE UNITED STATES DISTRICT COURT

Northern District of Indiana,
South Bend Division

Dodge Manufacturing Corporation et al.,
Plaintiffs,

v.

Emerson Electric Co.,
Defendant.

ORDER

(Filed June 8, 1967)

On June 2, 1967, this matter came on for hearing on plaintiffs' application for preliminary injunction. A temporary restraining order had been granted on May 27, 1967. The Court has heard the evidence, and adjourned to consider the matter. Having now carefully reviewed the record and in view of the authorities cited by the parties, the Court does now find and determine that the temporary restraining order heretofore granted should be dissolved and that the application for preliminary injunction should not be granted.

It is, therefore, Ordered that the temporary restraining order heretofore granted herein be, and the same is, hereby dismissed and dissolved, and

Ordered Further that plaintiffs' request for a preliminary injunction be, and the same is, hereby, Denied.

Any assessment of costs deemed to be necessary herein will be determined at the subsequent hearing on the pending application for Rule to Show Cause.

Robert A. Grant
Judge

Entered: June 8, 1967

Memorandum

The complaint in this case was brought by Dodge Manufacturing Corporation (Dodge) on its own behalf and on behalf of the shareholders of Dodge, and by Temple Williams and John R. Wood, Jr., shareholders of Dodge, proceeding "for themselves and as a class pursuant to Rule 23 . . . on behalf of all owners of shares of such common stock." The named defendant is Emerson Electric Co. (Emerson), a Missouri corporation. The suit was instituted under the provisions of Section 27 of the Securities Exchange Act of 1934 (15 U. S. C., § 78aa), alleging a violation of Section 10(b) of that Act (15 U. S. C., § 78j) and Rule 10b-5 promulgated thereunder. We have limited our consideration, therefore, to that evidence which would tend to prove such a violation.[1] Finding none, we must deny relief.

The pertinent statutory and regulatory provisions read as follows:

(1) Section 10(b):

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—(b) to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

(2) Rule 10b-5:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any

---

[1] A substantial amount of evidence, to which reference will later be made in this memorandum, was unrelated to the Section 10(b) issue.

> facility of any national securities exchange—(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

In this Court's view, the plaintiffs were put to the burden of showing that Emerson's May 22, 1967, Offer to Purchase certain shares of Dodge common stock was misleading in a material respect, whether by affirmative statement or by omission.

Emerson's offer to Dodge shareholders is embodied in three written documents: (1) The official public advertisement first printed in various newspapers on May 24, 1967; [2] (2) the Offer Letter, dated May 22, 1967; [3] (3) the Letter of Transmittal, which accompanied the Offer Letter, and which was the form to be used by any shareholder wishing to declare his stock available for the tender.[4] The advertisement referred to, and incorporated therein, the last two mentioned documents.

In substance, the offer invited tenders of 550,000 shares of Dodge common stock for purchase at $63.00 per share net to the tendering shareholders, payable in cash. The offer, dated May 22, 1967, by its terms, expired on June 2, 1967, at 5:00 P. M., Chicago time, unless extended by Emerson. All tenders were irrevocable until accepted or rejected. The Offer Letter quoted the yearly high and low prices for Dodge comon stock during 1964-66, and for the shorter period in 1967 through May 19, the last trading day prior to the date of the Offer Letter.

---

[2] First exhibit attached to the complaint.

[3] Plaintiffs' Exhibit 10.

[4] Plaintiffs' Exhibit 11.

The complaint contains numerous allegations of items which plaintiffs contend were omitted from the "tender offer" documents. Unquestionably such items were omitted, but there was a complete failure of proof that the omissions were, "in the light of the circumstances," misleading. Representative of this class of allegation (with no supporting evidence) are the following:

(1) "Emerson omitted to state the number of shares of Dodge which it presently owns"—there was no evidence to show that Emerson owned any shares;

(2) "Emerson omitted to state the extent to which it has acquired or is acquiring or is now negotiating to acquire or intends to acquire, shares of Dodge other than pursuant to the Offer"—no proof was offered as to Emerson's intentions, nor any intimation how this was misleading;

(3) "Emerson omitted to state whether it has any present plan or intention of making any other offer at the stated price or any other price per share or on any other terms or conditions"—again the plaintiffs made no effort to show that Emerson's failure to state its intentions in this regard could possibly be misleading;

(4) Emerson failed to state "that there had been prior merger negotiations between Emerson and Dodge which had been terminated when Dodge declined to recommend to its shareholders the previous offer made"—this omission was clearly immaterial in view of the fact that the Dodge management itself conveyed this information to its own shareholders by letter at least four weeks prior to the Emerson tender offer (Defendant's Exhibit No. 9);

(5) "Emerson omitted to disclose the material facts relating to the amount of money which would be required to be borrowed by it in order to purchase 550,000 shares of Dodge common at the offer price"—Plaintiffs made no attempt to substantiate this alle-

gation by proof that such information would be material to prospective sellers of stock.

Much of the testimony presented at the three-day hearing concerned certain alleged "confidential information" which Emerson is said to have acquired as a result of the prior merger negotiations between Dodge and Emerson. On April 20, 1966, representatives of Dodge and Emerson had their first meeting at the Dodge plant in Mishawaka, Indiana, to initiate discussions concerning the merger of Dodge into Emerson. Following a forenoon of discussions, the representatives of both parties went out together for lunch, traveling several miles to a South Bend club. Plaintiffs sought to show that during that afternoon, the Emerson representatives returned to the Dodge plant in Mishawaka where they were conducted through the Dodge facilities, including the research and development laboratories where certain new products were undergoing tests. Dodge's President described these as highly confidential revelations. However, the Emerson personnel categorically denied that such a tour ever occurred. This denial was supported by the introduction into evidence of the airplane pilot's log sheet for that date (Defendant's Exhibit No. 44) from the Emerson company plane, which indicated that the Emerson aircraft departed the South Bend airport that afternoon with the Emerson personnel aboard at 1:26 P. M. (Although the record is unclear at this point, this was probably 2:26 P.M., South Bend time.)

A series of meetings and conferences followed concerning the proposed merger, terminating on March 12, 1967, when the Dodge directors rejected the Emerson offer. The President of plaintiff Dodge testified that at various times throughout this period, he had disclosed to Emerson such information as a five-year forecast of Dodge earnings, reports on foreign operations, details of stock option and executive compensation plans, and sales and distribution policies. Emerson in rebuttal asserted that most of this information was publicly available dur-

ing and even prior to the merger negotiations, and that these public sources had been utilized by them in gathering data on Dodge. Evidence was adduced that Emerson had been considering a merger with Dodge for some time prior to April 20, 1966, and had engaged a business consultant to make an independent evaluation of that company. An important reference in this evaluation was Dodge's detailed 21-page Listing Application to New York Stock Exchange, dated November 30, 1964 (Defendant's Exhibit No. 32). This included an extensive catalog of Dodge property, foreign affiliation, stock option plan and financial reports. Further investigation and study included the Dodge 1966 Annual Report to Stockholders (Defendant's Exhibit No. 33), and the October 18, 1966, proxy statement (Defendant's Exhibit 33A).

Reason and experience support Emerson's position that it did not obtain confidential information from Dodge personnel. The merger talks never moved beyond the informal stages. At a November 10, 1966, meeting in St. Louis, Dodge was first presented with a form of preliminary written agreement called Outline Memorandum (Defendant's Exhibit No. 46), which set forth the understanding of the Boards of Directors of Emerson and Dodge. This Memorandum called for the execution of a formal Plan and Agreement of Reorganization, and prior hereto extended to Emerson the opportunity to make a thorough examination of the operations, contracts, agreements, loan agreements, assets, liabilities, past experience and future prospects of Dodge. Consummation of the Agreement was conditioned upon Emerson's "being reasonably satisfied with the results of such examination." Inasmuch as the parties never did execute this Outline Memorandum, such contemplated examination was never made and the compelling inference, when viewed in the light of all the other evidence on the point, is that Emerson was not in possession of confidential information on May 22, 1967.

It is the Court's conclusion, therefore, that Emerson was not possessed of "insider" information, placing it on unequal footing with prospective sellers under its tender offer. There is no doubt that Emerson had a sophisticated understanding of the worth of Dodge, perhaps an understanding superior to that of the average Dodge shareholder, but we find that this was obtained by a diligent and searching inquiry of public documents. Such industry is not, however, prohibited by Section 10(b).

Finally, Dodge offered testimony through its officers and directors that Emerson representatives had repeatedly asserted that Emerson would not make a tender offer to Dodge shareholders. In reliance upon these assertions, Dodge claims to have disclosed the alleged "confidential information." This alleged breach, standing alone, presents no claim under Section 10(b). Such evidence might be relevant to prove that Emerson breached a confidence then allegedly existing with Dodge, but the common law, not Section 10(b), provides the remedy for breach of a confidential relationship. However, since we find that no such information passed from Dodge to Emerson, there is no need to rest upon this technical distinction. There has been no breach of trust here.

The plaintiffs in this case have failed to satisfy their burden of proof to this Court that they are entitled to a preliminary injunction. It is not difficult to understand their concern over a proposal which, if successful, will transfer control of Dodge to Emerson. A tender offer, however, in and of itself, does not constitute an illegal method when an outsider challenges the existing corporate control. It may be a harsh reality of the market place, but it is not unlawful. In all fairness to the defendant, however, the Court must say that the course of dealing revealed by the evidence herein demonstrated ethical conduct on both sides, and no criticism to either party is hereby intended.

The Court concludes that the plaintiffs have failed to sustain their burden of proving their entitlement to a temporary injunction based upon the alleged violations by

defendant of Section 10(b) and Rule 10b-5 promulgated thereunder. Accordingly, the application for temporary injunction must be denied.

PLAINTIFF'S EXHIBIT 11.

5/27/67

To All Dodge Shareholders:

On Saturday May 27, 1967 the District Court of the United States for the North District of Indiana, South Bend Division, granted our request for a temporary restraining order against Emerson Electric Co. of St. Louis, Missouri, pending a hearing on a preliminary injunction which will be held Friday, June 2, 1967 at 2:00 P.M.

The order restrains Emerson Electric Co. from taking any action whatsoever in connection with Emerson's offer to purchase shares of stock of Dodge Manufacturing Corporation, including:

(1) Further publicizing such offer in the newspaper or otherwise,

(2) Accepting any tenders in respect to any such stock,

(3) Renewing the offer or making any other offer to purchase shares of stock of Dodge Manufacturing Corporation.

Enclosed for your further information is a copy of the order of the Court.

Sincerely yours

By order of the board of directors
J. A. MacLean, President

PLAINTIFF'S EXHIBIT 12.

Dated: May 29, 1967

To All Dodge Shareholders:

As indicated to you in our May 27 letter and attached court order, we were successful in having a temporary restraining order issued against Emerson Electric. One of the reasons this order was issued, was Emerson's failure to state material facts in its tender offer made to our shareholders.

In addition, we believe Emerson has issued several misleading and incorrect statements in an effort to confuse. Some of these statements, especially with respect to the true value of the Reliance Electric Company's offer, have recently appeared in the press, and I would like to take this opportunity to correct their erroneous evaluation.

Any offer such as this must take into consideration several facts to produce an honest value. In studying Reliance's offer we have been advised by leading investment banking firms that the new Reliance convertible preferred stock to be received tax-free by the Dodge shareholders, represents today a value superior to the taxable cash offer by Emerson.

The investment bankers' opinion of the value takes into account:

The $2.50 dividend rate on the new preferred issue, which is 70¢ higher than the present Dodge dividend,

The combined earnings of Dodge and Reliance after the preferred dividend is paid,

The normal premium price the market places on the option to convert the new preferred shares into Reliance common shares (1.4 shares of common to one share of preferred),

The tax-free nature of the proposal.

For your information, Reliance earnings were $7,903,000, or $2.69 per share for their fiscal year ended October 31, 1966, and were $8,346,000, or $2.84 per share for the

last twelve months ended April 30, 1967. Since 1962 our sales were up 55% and earnings up 188%.

We believe the tax-free aspect of the transaction will be a major benefit to many of you. The capital gains tax on shares which might be sold to Emerson would substantially reduce a shareholder's profit.

To help you in evaluating this, we have prepared the following chart:

Your Original Purchase Price of Dodge Shares	Capital Gains Tax at 25%	Net Receivable to Dodge Shareholders
$ 5.00	$14.50	$48.50
10.00	13.25	49.75
15.00	12.00	51.00
20.00	10.75	52.25
25.00	9.50	53.50
30.00	8.25	54.75
35.00	7.00	56.00
40.00	5.75	57.25
45.00	4.50	58.50

Your board of directors, your officers and I, believe the Emerson offer to be unsatisfactory and urge you to reject it. We feel you deserve a better deal and we believe the Reliance proposal to be a better deal. Consequently, we will continue to take all necessary steps to oppose the Emerson offer.

We wish to thank the thousands of shareholders of Dodge who have already indicated their desire to remain loyal to our company.

Sincerely yours

By order of the board of directors
J. A. MacLean, President

PLAINTIFF'S EXHIBIT 14.

(Letterhead of Dodge Manufacturing Corporation, Mishawaka, Indiana)

June 12, 1967

Dear Fellow Shareholder:

Our letter of June 8, 1967 informed you of the approval by your Board of a formal merger agreement between Dodge Manufacturing Corporation and Reliance Electric Company of Cleveland.

Your Board of Directors and Management believe there would be significant advantages to you as a shareholder through this merger compared to Emerson's conditional cash offer. We again call to your attention the following important features provided in the proposed merger:

—The exchange of one share of common stock of Dodge Manufacturing for one share of cumulative convertible preferred stock of Reliance Electric Company.

—A 39% increase in dividends—$2.50 per share on the new preferred stock compared to $1.80 per share on your present common stock.

—Each share of the new cumulative preferred stock would be convertible into 1.4 shares of Reliance common stock at any time.

—The new cumulative preferred stock would be non-callable for 5 years, callable thereafter at $70 and would have one vote per share.

—The merger agreement provides for a ruling by the Internal Revenue Service that the exchange of stock is a tax-free transaction.

Reports are circulating that the Dodge-Reliance merger would require 80% support of the outstanding Dodge stock to obtain tax-free status. This is not true. Our legal counsel advise that the proposed statutory merger of Dodge and Reliance requires only 50+ percent support

of the outstanding Dodge stock in order to obtain for those shareholders exchanging their shared tax-free status under Internal Revenue Code.

Accordingly, we are convinced that your interests will best be served by retaining your investment in Dodge and rejecting Emerson's taxable cash offer.

Sincerely

By Order of the Board of Directors
/s/ J. A. MacLean
J. A. MacLean
President

PLAINTIFF'S EXHIBIT 15.

Emerson Electric Co.
8100 Florissant Avenue
St. Louis, Mo 63136

June 17, 1967

Mr. J. Allan MacLean,
President,
Dodge Manufacturing Corporation,
Mishawaka, Indiana

and

To all Members of the Board of Directors of Dodge Manufacturing Corporation

Gentlemen:

This letter supplements our letter to you of June 15, 1967, relating to the merger proposal of Emerson Electric Co. (Emerson) to Dodge Manufacturing Corporation (Dodge).

As a substantial shareholder of Dodge, Emerson desires to communicate with the other shareholders of Dodge regarding this merger proposal. For this purpose, and in order to communicate with the shareholders of Dodge

regarding the proposal that Dodge merge with Reliance Electric and Engineering Company, we request, pursuant to Section 11 of the Indiana General Corporation Act, that we be permitted immediate right to inspect, examine and copy the current list of Dodge shareholders.

We request you to advise us promptly of the time and place when we may inspect, examine and copy such list, or the time and manner in which you will supply us with a copy of same at our expense. If we do not hear from you on or before the close of business on June 23, 1967, we will assume you have refused this request.

You are hereby advised that Emerson intends to solicit proxies for the Special Meeting of Dodge shareholders scheduled to be held August 22, 1967, in opposition to the approval of the proposed merger between Dodge and Reliance Electric and Engineering Company. In this connection, will you please furnish to us all information required in order to permit Emerson to comply with applicable rules and regulations of the Securities and Exchange Commission, including, but not limited to, the information relating to Dodge required to be included in Items 14 and 15 of Schedule 14A of the SEC Proxy Rules and that required under Rule 14A-7 thereof.

Emerson hereby offers to furnish similar information relating to it should you determine to provide your shareholders the right to decide which of the two merger proposals offers them the greater economic benefit.

You are further notified that Emerson intends to present at the Special Meeting of shareholders of Dodge on August 22, 1967, the following proposal:

> Resolved, that a majority of the shareholders of Dodge Manufacturing Corporation desire the opportunity to consider the agreement of merger proposed to be entered into between Emerson Electric Co. and Dodge Manufacturing Corporation, and hereby call upon the Directors of the corporation, acting as a Board of Directors, to take all action necessary and appropriate pursuant to the provisions of Article 4 of Part 2 of the General Corporation Act of the State of

Indiana, to approve and cause to be submitted to the shareholders of Dodge Manufacturing Corporation such agreement of merger.

You are, accordingly, requested to include this proposal in your proxy material.

Very truly yours

/s/ W. R. Persons

W. R. Persons

Chairman of the Board

PLAINTIFF'S EXHIBIT 16.

Wall Street Journal—Monday, June 19, 1967

To all shareholders of
Dodge Manufacturing Corporation

The following letter and proposal were sent to Mr. J. Allan MacLean, President and all members of the Board of Directors of Dodge Manufacturing Corporation, on Thursday, June 15, 1967.

Gentlemen:

Please be advised that, pursuant to a resolution duly adopted by its Board of Directors, Emerson Electric Co. hereby offers to enter into a joint agreement of merger with Dodge Manufacturing Corporation providing for a tax-free merger of Dodge into Emerson and providing for the conversion of each share of Dodge Common Stock into one share of a new Cumulative Convertible Preferred Stock, Series B, of Emerson, having an annual dividend rate of $2.76 per share, payable quarterly, and being convertible into .9 share of Emerson Common Stock, noncallable for six years and callable thereafter at $86.00 per share, the call price declining annually at the rate of $1 each year for six years.

A copy of a formal joint agreement of merger, or articles of merger, embodying the foregoing and other pertinent provisions, duly approved by the Board of Directors of Emerson, will be forwarded to each of you within the next few days.

Such joint agreement or articles of merger will be submitted to vote at a meeting of the shareholders of Emerson duly called to be held August 18, 1967. We believe that this proposed joint agreement or articles of merger merits your favorable consideration and request that you duly approve it and submit it to a vote of your shareholders at the meeting which we are advised you have called for August 22, 1967. If you consider that you are already bound by and cannot withdraw any prior approval that you may have given to the proposed agreement of merger with Reliance Electric and Engineering Company which has been reported in the public press, then we suggest that you approve the joint agreement or articles of merger with Emerson and submit the same to a vote of the Dodge shareholders at the meeting called to be held on August 22, 1967, subject to such action as your stockholders may take on the proposed merger with Reliance. We wish to emphasize that the merger being proposed will be on a tax-free basis.

For your information, Emerson plans to offer to each of those shareholders of Dodge whose shares have been purchased by Emerson pursuant to its published Offer to Purchase the right to purchase promptly after the consummation of the merger such number of shares of the Emerson Cumulative Convertible Preferred Stock, Series B, as each of them would have been entitled to receive in the merger if he had not tendered his shares to Emerson, upon repayment to Emerson of the net price paid for his shares.

Very truly yours

W. R. Persons

Chairman of the Board

We believe that this tax-free merger proposal is in the best interest of all Dodge shareholders as well as, its management and employees. We urge you to communicate with the Directors of Dodge Manufacturing and ask that you be given the opportunity to vote on this alternative merger proposal at the meeting on August 22, 1967. *As shareholders, this right should not be denied to you.* We intend to solicit your proxy for that meeting after clearance of a definitive proxy statement by the Securities and Exchange Commission.

Emerson Electric wishes to re-emphasize that if its merger proposal is accepted, it fully intends to maintain the operations of Dodge Manufacturing in their present Mishawka-South Bend location and substantially to continue the Company's present policies, practices and employment.

Emerson Electric Co.

June 19, 1967

PLAINTIFF'S EXHIBIT 17.

Dodge Manufacturing Corporation
Mishawka, Indiana
June 20, 1967

Mr. W. R. Persons
Chairman of the Board
Emerson Electric Company
8100 Florissant Avenue
St. Louis, Missouri 63136

Dear Mr. Persons:

On Saturday, June 17, just before noon, delivery was made at my home and at my office of your letter of June 15. This will acknowledge receipt of this letter.

Your proposal to the Dodge Board, as described in your letter of June 15, will be considered by the Dodge Board in due course.

Very truly yours
/s/ J. A. MacLean
J. A. MacLean

JAM:m

PLAINTIFF'S EXHIBIT 18.

Emerson Electric Co.
8100 Florissant Avenue
St. Louis, Mo. 63136

June 21, 1967

Mr. J. Allan MacLean, President
Dodge Manufacturing Corporation
Mishawaka, Indiana

and

To all Members of the Board of Directors of Dodge Manufacturing Corporation

Gentlemen:

This letter further supplements our letter to you of June 15, 1967 and supplements our letter to you of June 17, 1967.

Enclosed herewith please find Printer's Proof dated 6/21/67 of a Plan and Joint Agreement of Merger between Emerson Electric Co. (Emerson) and Dodge Manufacturing Corporation (Dodge), which has been duly approved by our Board of Directors, and which Plan and Joint Agreement of Merger Emerson, Pursuant to resolution duly adopted by its Board of Directors on June 17, 1967, hereby offers to execute and consummate, subject to and immediately following the obtaining of such approvals as may be required by Indiana and Missouri law.

Emerson's Board of Directors has, by resolution, directed that this Plan and Joint Agreement of Merger be submitted to Emerson's shareholders at a Special Meeting called to be held on August 18, 1967, at which meeting we anticipate that Emerson's stockholders will give all approvals required by Missouri law and will take all corporate action necessary and proper to authorize the due execution and consummation of such Plan and Joint Agreement of Merger.

Furthermore, in the event that the Board of Directors of Dodge, or any officer of Dodge acting pursuant to due authorization of its Board, shall at any time duly approve

any amendment, modification or change in the proposed agreement of merger with Reliance Electric and Engineering Company (Reliance) which has been reported in the public press, or any new agreement of merger with Reliance, or any agreement for the sale of substantially all of its assets to Reliance, or any agreement of merger with, or agreement for the sale of substantially all of its assets to, any other company, the effect of which, in the opinion of Emerson, is to offer to the shareholders of Dodge a proposal which is more favorable to such shareholders than the one of Reliance which has heretofore been reported in the public press, then and in any such event Emerson reserves the right and option, but shall not be obligated, to withdraw this offer, at any time thereafter, by written notice to Dodge of its intention so to do, sent by registered mail.

We are sending this Plan and Joint Agreement of Merger to you in Printer's Proof form because it occurs to us that you may wish to suggest some changes, amendments or modifications in the language of this proposed Plan and Joint Agreement of Merger, but not affecting the substantive terms thereof, including, for example, provisions with respect to employment of officers and executives and Board representatives, in which event we will be glad to consider and discuss the same with you and make all reasonable efforts to arrive at an agreement with respect thereto.

However, if you do not have any such changes, amendments or modifications which we may agree upon, then our offer is to seek all necessary approvals required by Missouri law and, upon your obtaining such approvals as may be required by Indiana law, to duly execute and consummate this Plan and Joint Agreement of Merger in final printed form.

Very truly yours

W. R. Persons

Chairman of the Board

PLAINTIFF'S EXHIBIT 19.

Dodge Manufacturing Corporation
Mishawaka, Indiana
June 22, 1967

Executive Offices

AIRMAIL SPECIAL DELIVERY

Mr. W. R. Persons
Chairman of the Board
Emerson Electric Co.
8100 Florissant Avenue
St. Louis, Missouri 63136

Dear Mr. Persons:

Reference is made to your letter of June 17, 1967, addressed to myself and all members of the Board of Directors of Dodge Manufacturing Corporation. This response has been ordered by the Dodge Board of Directors.

In your letter, you state that Emerson intends to solicit proxies for the special meeting of shareholders of Dodge scheduled to be held August 22, 1967, in opposition to the proposed merger of Dodge into Reliance Electric Company. You request that Dodge permit Emerson to inspect, examine and copy the current list of Dodge shareholders to enable you to carry out its proxy solicitation. You also ask that Dodge furnish Emerson with the information called for by Regulation 14a-7 of the S.E.C. Proxy Rules.

This is to advise you that Dodge intends to solicit proxies from all holders of record of its common shares. There are at present approximately 3,000 such holders. Dodge further intends to make a solicitation of the beneficial owners of its common shares held in names of brokerage firms, banks, etc. Dodge does not know the number of such beneficial owners, but approximately 135 of the total number of record holders of Dodge common shares are brokerage firms, banks, etc., which may be holding such shares for one or more beneficial owners.

Dodge estimates that such beneficial owners may aggregate 1,000 persons. Finally, we are unable to give you at the present time any estimate of the cost of mailing Emerson's proxy statement, form of proxy, or other statement to such holders. However, if you will deliver to us copies of such material, we will furnish you with such a cost estimate as soon as reasonably possible. I believe that the foregoing supplies you with the information called for by Regulation 14a-7(a). In addition, in accordance with the provisions of Regulation 14a-7(b), following their clearance by the S.E.C., we will mail your proxy statement, form of proxy, or other communication to the Dodge shareholders, upon your defraying the reasonable expenses to be incurred by Dodge in doing so. Under the provisions of Regulation 14a-7(b)(2), such material need not be mailed by Dodge prior to the first day on which solicitation is made on behalf of Dodge. For your information, July 14, 1967, has been fixed as the record date for shareholders entitled to vote at the August 22 meeting. I believe that the foregoing constitutes full compliance with Regulation 14a-7 and eliminates the need for Emerson to examine the Dodge shareholders list for the purpose of communicating with the Dodge shareholders. In any event, only shareholders of record on July 14 will be eligible to vote at the meeting on August 22, so that the present list of shareholders has no materiality to proxy solicitation for such meeting.

Inasmuch as no agreement of merger between Dodge and Emerson has been approved by the Dodge Board of Directors at the present time, the information prescribed in Items 14 and 15 of Schedule 14A to the S.E.C. Proxy Rules is not required by Emerson. Accordingly, such information cannot be released to you at this time. However, in connection with the proposed merger of Dodge into Reliance Electric Company, the Dodge proxy statement will comply with the provisions of Items 14 and 15 of Schedule 14A. Emerson will receive such proxy statement as a shareholder of Dodge.

Finally, in accordance with Regulation 14a-8(c)(1) of the Proxy Rules, you are hereby notified that the proposal submitted with your letter of June 17 is not a proper subject for action by shareholders of Dodge. Accordingly, Dodge intends to omit such proposal from its proxy statement. A copy of the opinion of counsel upon which Dodge relies in this connection is enclosed.

Copies of this letter, of your letter of June 17, and of the opinion of counsel above referred to, are being mailed to the Securities and Exchange Commission in accordance with Regulation 14a-8(d).

Very truly yours,

Dodge Manufacturing Corporation
By /s/ J. A. MacLean
President

PLAINTIFF'S EXHIBIT 20.

Cause No. D-3655.

IN THE ST. JOSEPH SUPERIOR COURT DIVISION

State of Indiana, St. Joseph County, ss.

State of Indiana on the relation of Emerson Electric Co., a Missouri Corporation,

Plaintiff,

v.

Dodge Manufacturing Corporation, an Indiana Corporation, J. Allan MacLean and Karl D. Jahnke,

Defendants.

COMPLAINT

Count I

Action for Mandate

State of Indiana on the relation of Emerson Electric Co. (Emerson), relator, submits the following complaint against the above named defendants:

1. Relator is a corporation organized and existing under and by virtue of the laws of the State of Missouri, with its principal place of business and executive offices in St. Louis, Missouri.

2. Defendant Dodge Manufacturing Corporation (Dodge), is a corporation organized and existing under and by virtue of the laws of the State of Indiana, with its principal offices and place of business located in Mishawaka, Indiana.

3. Defendant J. Allan MacLean at all times referred to herein has been the President and Chief Executive Officer of Dodge. Defendant Karl D. Jahnke at all times referred to herein has been the Secretary of Dodge. De-

fendants MacLean and Jahnke are citizens and residents of Indiana. The individual defendants have authority and control over the records of Dodge, including those which contain the names and addresses of record owners and the number of shares owned of record by each shareholder.

4. Relator is and was at the time of the demand for shareholders' list hereinafter alleged a shareholder of record of common stock of Dodge and owns in excess of 100,000 shares of said stock.

5. On information and belief, approximately 1,144,000 shares of Dodge common stock are issued and outstanding, owned of record of more than 3,000 shareholders. Relator is informed and believes that it is the largest single shareholder of Dodge common stock.

6. On June 8, 1967, defendant MacLean notified all Dodge shareholders and publicly announced on behalf of Dodge that the Dodge Board of Directors had approved a formal agreement of merger with Reliance Electric and Engineering Company of Cleveland, Ohio. Defendant MacLean stated that the shareholders of Dodge would be asked by the management to approve said plan of merger at a special meeting of shareholders to be held August 22, 1967. Defendant Dodge had previously communicated with all its stockholders on occasions in May, 1967, with respect to the contemplated Reliance merger.

7. On June 15, 1967, relator mailed to Dodge and to the individual defendants a letter offering (subject to the approval of relator's shareholders) a plan for the merger of Dodge and Emerson. A copy of this letter is attached to and made a part of this complaint as Exhibit A. Said letter stated that a formal plan of merger would be forwarded to Dodge as soon as it could be prepared. On June 21, 1967, printer's proofs of the formal plan of merger thus described were forwarded to Dodge by relator, together with a covering letter. A copy of said letter of June 21, 1967, is attached to and made a part of this complaint as Exhibit B.

8. Relator has not received any response from defendants concerning whether they propose to accept or reject relator's said offer of merger.

9. On June 17, 1967, relator mailed to defendants a letter advising them that relator intends to solicit proxies for the special meeting of Dodge shareholders scheduled to be held August 22, 1967, (a) in opposition to approval of the proposed merger between Dodge and Reliance Electric and Engineering Company, and (b) in support of the following proposal to be submitted by relator at said special meeting of shareholders:

> Resolved, that a majority of the shareholders of Dodge Manufacturing Corporation desire the opportunity to consider the agreement of merger proposed to be entered into between Emerson Electric Co. and Dodge Manufacturing Corporation, and hereby call upon the Directors of the corporation, acting as a Board of Directors, to take all action necessary and appropriate pursuant to the provisions of Article 4 of Part 2 of the General Corporation Act of the State of Indiana, to approve and cause to be submitted to the shareholders of Dodge Manufacturing Corporation such agreement of merger.

Said letter of June 17, 1967, further stated that relator is a substantial shareholder of Dodge, and that relator desires to communicate with the other shareholders of Dodge concerning the proposed merger of Dodge and Reliance Electric and Engineering Company and concerning relator's merger proposal of June 15, 1967. The letter then requested that relator be permitted the immediate right to inspect, examine and copy the current list of Dodge shareholders, pursuant to Section 11 of the Indiana General Corporation Law [Burns, Indiana Stats., § 25-210]. A copy of the letter of June 17, 1967, is attached to and made a part of this complaint as Exhibit C.

10. Information relative to the formal plan of merger proposed by Emerson is material and relevant to a decision on the part of the shareholders of Dodge to accept

or reject the recommendation of the Dodge Board of Directors that the Reliance plan of merger be adopted. Only by having this information available to them can the shareholders make an intelligent comparison of the two offers, and act in their own best interests. Failure of Dodge to communicate this information to its shareholders renders the Dodge communications to its shareholders incomplete and misleading. Emerson desires to make this information available immediately to all other shareholders.

11. Section 11 of the Indiana General Corporation Law provides:

> "Each corporation shall keep correct and complete books of account and minutes of the proceedings of its shareholders and directors; and shall keep at its principal office an original or a duplicate stock register or transfer book, or, in case such corporation employs a stock registrar or transfer agent in this or any other state, a complete and accurate shareholders' list giving the names and addresses of all shareholders and the number and classes of shares held by each. All such books, records and lists of a corporation shall be open to inspection and examination during the usual business hours for all proper purposes by every shareholder of the corporation, or his duly authorized agent or attorney." Burns, Ind. Stats., § 25-210.

12. On June 23, 1967, relator received a letter from Dodge, signed by defendant MacLean, dated June 22, 1967, denying relator's request as contained in its letter of June 17, 1967. A copy of said letter of June 22, 1967, is attached to and made a part of this complaint as Exhibit D.

13. The letter of June 22, 1967 (Exhibit D) states in part:

> "This is to advise you that Dodge intends to solicit proxies from all holders of record of its common shares. There are at present approximately 3,000

such holders. Dodge further intends to make a solicitation of the beneficial owners of its common shares held in names of brokerage firms, banks, etc. Dodge does not know the number of such beneficial owners, but approximately 135 of the total number of record holders of Dodge common shares are brokerage firms, banks, etc., which may be holding such shares for one or more beneficial owners. Dodge estimates that such beneficial owners may aggregate 1,000 persons."

14. The only reasons set forth by defendants in their letter of June 22, 1967 (Exhibit D) for their refusal to give relator access to the current Dodge shareholder list are:

(a) that Dodge will undertake to mail a proxy statement and form of proxy for relator prior to the proposed August 22, 1967 meeting pursuant to the requirements of Rule 14a-7 promulgated by the Securities and Exchange Commission; and

(b) that since the record date for the proposed August 22, 1967 meeting is July 14, and since only shareholders of record on July 14 will be eligible to vote at the August 22 meeting "the present list of shareholders has no materiality to proxy solicitation for such meeting."

Neither of these purported reasons constitutes good cause for denying relator's right to inspect, examine and copy Dodge's current shareholder list.

15. Relator intends to solicit proxies for the special meeting of Dodge shareholders scheduled to be held August 22, 1967, in opposition to the approval of the proposed merger between Dodge and Reliance Electric and Engineering Company, and in favor of the proposal set forth in paragraph 9 hereof, calling upon the Dodge Board of Directors to permit the Dodge shareholders to express their approval or disapproval of relator's proposal of merger with Dodge. Relator believes that its merger proposal is more favorable to Dodge and to the

shareholders of Dodge than the proposed plan of merger between Dodge and Reliance Electric and Engineering Company, and relator believes that rejection of the proposal for merger with Reliance and acceptance of relator's proposal would be in the best interests of Dodge and of Dodge shareholders, including relator. For these reasons, relator desires to communicate with the other shareholders of Dodge regarding the proposal for merger with Reliance and regarding its proposed resolution referred to in paragraph 9 of this complaint. For these purposes relator seeks to inspect, examine and copy the current list of Dodge shareholders, pursuant to Section 11 of the Indiana General Corporation Law.

16. Under Section 11 of the Indiana General Corporation law, relator has a right to inspect, examine and copy the current list of Dodge shareholders, and defendants are required by law to permit relator immediate access to such list of shareholders for those purposes. Defendants' unlawful and wrongful refusal to permit relator to inspect, examine and copy said shareholders list is without warrant of law and is arbitrary and capricious.

17. The purported reasons given in defendants' June 22, 1967 letter (Exhibit D) for said refusal are insufficient in law. Relator's right to access to the shareholders' list under Section 11 of the Indiana General Corporation Law is not affected by the requirement of federal law that Dodge mail relator's proxy statement to the Dodge shareholders. Further, relator cannot effectively communicate with other Dodge shareholders prior to the August 22, 1967 meeting if relator is required to wait upon the preparation in late July of a list of Dodge shareholders as of July 14, 1967. Relator's right to access to said list under Section 11 of the Indiana General Corporation Law is not limited to the list as of the record date for a particular shareholders' meeting.

18. Relator is entitled to a Mandate compelling defendants to produce forthwith the current list of record owners of shares of Dodge common stock, with the names and addresses and number of shares owned by each share-

holder for inspection, examination and copying by relator, at a time and place to be fixed by the Court.

19. Relator has suffered irreparable damage by reason of defendants' refusal to grant relator access as aforesaid to said shareholder list and relator will suffer further irreparable damage unless it is promptly granted access to such list. The individual defendants and the Dodge Board of Directors have approved the proposal for a merger of Dodge and Reliance, and intend to urge the shareholders of Dodge to accept said proposal at the special meeting called for August 22, 1967, and to solicit from said shareholders proxies to be voted in favor of the Reliance merger proposal. Relator believes that it is in the best interests of Dodge and of the shareholders of Dodge, including relator, that the Reliance merger proposal be rejected, and that relator's merger proposal be adopted. Relator cannot effectively communicate its views with respect to these merger proposals to other Dodge shareholders or effectively attempt to convince a majority of Dodge shareholders to reject the Reliance merger proposal and adopt relator's merger proposal, unless relator is granted immediate access to the current list of Dodge shareholders and is permitted to inspect, examine and copy said list.

20. Unless this Court's Mandate is issued immediately, relator will not have adequate time and opportunity to communicate with other stockholders prior to August 22, 1967, the date defendants plan to hold the aforesaid special meeting. An emergency therefore exists that requires immediate relief to protect relator's rights. In the interest of justice, therefore, the time within which defendants should answer the complaint herein should be fixed at two days after service of summons upon them, and the hearing should be held immediately.

Wherefore, relator Emerson Electric Co. prays:

A. That this cause be heard and determined as an emergency matter at the earliest possible time, that the summons require the defendants to appear and answer the complaint two days after the service of summons upon

them, and that the cause be set for hearing immediately thereafter.

B. That a Mandate be issued, directed to defendants Dodge Manufacturing Corporation, J. Allan MacLean and Karl D. Jahnke, commanding them and each of them to produce forthwith a current list of the shareholders of record of Dodge Manufacturing Corporation, showing the names and addresses of and the number of shares owned by each shareholder, to permit relator to examine, inspect and copy said information at a time and place to be fixed by the Court;

C. That defendants be enjoined from holding the scheduled Dodge shareholders' meeting or any other Dodge shareholders' meeting and soliciting proxies for any such meeting until such names and addresses are furnished and relator is given adequate time and opportunity to communicate with other shareholders and beneficial owners;

D. That relator have such other and further relief in the premises as the Court shall deem just and proper.

Emerson Electric Co.

By _____
William F. McInerny

_____
Albert E. Jenner, Jr.

_____
Samuel W. Block

_____
Wesley G. Hall
Its Attorneys

Chapleau, Roper, McInerny & Farabaugh
301-09 St. Joseph Bank Building
South Bend, Indiana 46601
Tel. 233-5773

Raymond, Mayer, Jenner & Block
135 South LaSalle Street
Chicago, Illinois 60603
Tel. RA-6-0220

Cause No. D 3655

IN THE ST. JOSEPH SUPERIOR COURT
DIVISION

State of Indiana, St. Joseph County, ss.

State of Indiana on the Relation of Emerson Electric Co., a Missouri Corporation,

Plaintiff,

v.

Dodge Manufacturing Corporation, an Indiana Corporation, J. Allan MacLean and Karl D. Jahnke,

Defendants.

ORDER

(Filed June 30, 1967)

This cause having come on to be heard pursuant to complaint for writ of mandate, and the parties having appeared in open court by their counsel, the plaintiff having advised the court that it intends to use the current and supplemental lists of the shareholders of record of Dodge Manufacturing Corporation which it seeks to obtain by this action solely in connection with the solicitation of proxies and the mailing of materials relating thereto in compliance with applicable rules and regulations of the Securities and Exchange Commission, and the parties having stipulated that the defendants shall furnish a current list of the shareholders of record of Dodge Manufacturing Corporation and supplementary information as to changes in the list as they occur from day to day;

It Is Ordered That, pursuant to agreement of the parties, defendants shall forthwith cause Harris Trust and Savings Bank, Chicago, Illinois, the transfer agent for Dodge Manufacturing Corporation, to prepare at relator's expense a current list of the shareholders of record of

Dodge Manufacturing Corporation (and such number of copies as relator shall desire) showing the names and addresses and the number of shares owned by each shareholder, and to deliver the same to relator Emerson Electric Co., on or before the close of business on July 5, 1967, and that defendants shall thereafter furnish to relator at relator's expense a like number of copies of supplementary information as to changes in the shareholders of record of Dodge Manufacturing Corporation as those changes occur from day to day.

Dated June 30, 1967.

Enter:

Norman Kopue
Judge

PLAINTIFF'S EXHIBIT 21.

(Letterhead of Emerson Electric Co.,
St. Louis, Mo. 63136)

June 29, 1967

Mr. J. Allan MacLean, President
Dodge Manufacturing Corporation
Mishawaka, Indiana

and

To All Members of the Board of Directors
of Dodge Manufacturing Corporation

Gentlemen:

This supplements my letter to you of June 21, 1967 which transmitted to you a proposed Plan and Joint Agreement of Merger (the Plan) between Emerson Electric Co. (Emerson) and the Dodge Manufacturing Corporation (Dodge) in printer's proof form. Since Emerson has received no reply to that letter, it has proceeded to

have the Plan put into final form, printed and signed on behalf of Emerson. Blanks which existed in the proof form have been completed and certain additional changes have been made in the final printing. We do not believe you will find these to constitute any substantial departure from the basic terms of the Plan as previously forwarded.

A copy of the Plan, in final form and signed by Emerson, is transmitted herewith by Emerson as Emerson's merger proposal to Dodge. This Plan has been duly approved by the Directors of Emerson and will be submitted for approval by its stockholders at a Special Meeting of such stockholders called to be held for such purpose on August 18, 1967. If you believe any amendment to the Plan in its present form is necessary prior to the approval of the Plan by the Board of Directors of Dodge or submission to the stockholders of Dodge, Emerson stands ready to discuss with you any reasonable proposed amendments. You will note that, pursuant to Article VI of the Plan, amendments may be made to the Plan by agreement between Emerson and Dodge.

This Plan in final form is submitted to you on the same condition stated in my letter to you of June 21, 1967, as follows:

> "Furthermore, in the event that the Board of Directors of Dodge, or any officer of Dodge acting pursuant to due authorization of its Board, shall at any time duly approve any amendment, modification or change in the proposed agreement of merger with Reliance Electric and Engineering Company (Reliance) which has been reported in the public press, or any new agreement of merger with Reliance, or any agreement for the sale of substantially all of its assets to Reliance, or any agreement of merger with, or agreement for the sale of substantially all of its assets to, any other company, the effect of which, in the opinion of Emerson, is to offer to the shareholders of Dodge a proposal which is more favorable to such shareholders than the one of Reliance which has heretofore been reported in the public press, then and in

any such event Emerson reserves the right and option, but shall not be obligated, to withdraw this offer, at any time thereafter, by written notice to Dodge of its intention so to do, sent by registered mail."

Yours very truly,
W. R. Persons
Chairman of the Board
Emerson Electric Co.

PLAINTIFF'S EXHIBIT 23.

(Letterhead of Dodge Manufacturing Corporation, Mishawaka, Indiana)

June 30, 1967

Mr. W. R. Persons
Chairman of the Board
Emerson Electric Co.
8100 Florissant Avenue
St. Louis, Missouri 63136

Dear Mr. Persons:

This will acknowledge receipt of your letters of June 27 and June 29, transmitting the final printing of a proposed Agreement of Merger, the printer's proof of which was received with your letter of June 21.

As has been publicly announced, our Board of Directors has approved, and, at their instructions, I have signed a formal merger agreement with Reliance Electric and Engineering Company, which agreement is scheduled to be submitted to our shareholders on August 22. The Indiana law requires that any merger agreement must first be acted upon by the board of directors before being submitted to the shareholders. Inasmuch as our Board has approved an agreement of merger with Reliance, it is not in position at this time to act upon the proposed agreement which you have sent to us.

Our Board of Directors does have this entire matter under further consideration.

Very truly yours,
/s/ J. A. MacLean
J. A. MacLean
President

JAM:m

PLAINTIFF'S EXHIBIT 24.

Emerson Electric Co.
8100 Florissant Avenue
St. Louis, Mo. 63136

July 14, 1967

Important Message to Shareholders of
Dodge Manufacturing Corporation

The management of Dodge Manufacturing Corporation has just sent (or "will shortly send") you a Notice of Special Meeting of Dodge shareholders to be held August 22, 1967 to vote on a proposed merger of Dodge into Reliance Electric Co. We oppose that merger and will urge Dodge shareholders to vote against it.

1. We do not think it is a good merger for Dodge. We own 151,982 shares (approximately 13.2%) of Dodge's common stock and we are its largest single shareholder. We will vote all our shares against the Reliance deal.

2. Emerson Electric Co. has made its own merger offer to the Board of Directors of Dodge which we believe is far more attractive and advantageous to Dodge shareholders than the Reliance deal. Since under Indiana law mergers must be initiated by the Directors of a Company, we will ask the Dodge share-

holders to adopt a resolution urging the Dodge Board of Directors to act favorably on the Emerson merger and to bring it to the shareholders for a vote.

Material setting forth in detail the reasons for our opposition to the Reliance merger and explaining the Emerson proposal is under preparation, and will be mailed to you shortly.

In the meantime, we ask only one thing of you—withhold your judgment and your vote. The August 22 meeting is a long way off and you will have plenty of time to make up your mind after you have all of the facts. Your right to vote will not be affected since you may vote by mail at any time prior to the meeting on August 22, or in person at the meeting.

/s/ W. R. Persons
W. R. Persons
Chairman of the Board

PLAINTIFF'S EXHIBIT 25.

Civil No. 4050.

UNITED STATES DISTRICT COURT

for the Northern District of Indiana
South Bend Division

Emerson Electric Co., a Missouri Corporation,
Plaintiff,

v.

Dodge Manufacturing Corporation, an Indiana Corporation, J. Allan MacLean, Karl Jahnke, Carl W. Petersen, Fred J. Ebeling, Marquard J. Anderson, Walter J. Buettner, Sidney B. Hainsworth, Charles E. Heitman, Jr., Harry D. Orr, Jr., and John R. Wood, Jr.,
Defendants.

COMPLAINT

* * * * *

Wherefore, Plaintiff Emerson Electric Co. prays for judgment against the defendants:

A. Preliminarily, pending the determination of this action, and permanently thereafter, restraining and enjoining the defendants, their officers, directors, managers, agents, servants and employees and all persons acting in concert with them:

(1) from calling or holding a special meeting of stockholders of Dodge Manufacturing Corporation for or on August 22, 1967 or for or on any other date to consider any proposal to merge or consolidate Dodge with Reliance Electric Engineering Company or from sending or causing to be sent to any Dodge shareholder any proxy statement or other proxy-soliciting material, or from otherwise soliciting proxies from Dodge shareholders or vot-

ing directly or indirectly any proxies which defendants now hold or hereafter acquire for such proposals until defendants

(a) correct the false and misleading statements referred to in the complaint;

(b) give plaintiff access to all proxy-soliciting materials which defendants propose to send to any Dodge shareholder and correct any false or misleading statements which may be found to exist in such proxy-soliciting materials;

(c) furnish Dodge shareholders with complete and accurate information with respect to plaintiff's merger proposal of June 15, 1967;

(d) accord plaintiff sufficient information and time effectively to communicate with other Dodge shareholders and owners of beneficial interest in Dodge stock and to solicit their proxies with respect to the matters to be brought before such meeting.

(2) From mailing any proxy solicitations or other communications to Dodge stockholders until plaintiff has had an opportunity to prepare its proxy solicitation material, to the end that proxy solicitations and any other mailings to stockholders by plaintiff and defendants prior to any such special meeting be made simultaneously.

B. Requiring that defendants correct the false and misleading statements described in this complaint;

C. Requiring that defendants furnish Dodge shareholders with complete and accurate information with respect to plaintiff's merger proposal of June 15, 1967;

D. Requiring defendants to consider plaintiff's merger proposal on its merits and thereafter requir-

ing them either to approve plaintiff's said merger proposal and submit that proposal to Dodge shareholders for adoption, or if defendants do not approve that proposal, to include plaintiff's Resolution, set forth in Paragraph 24, of this complaint, in their proxy-solicitation materials mailed to Dodge shareholders in connection with any meeting at which the Reliance offer is considered and to submit that Resolution to be voted on at said meeting; and

E. Granting plaintiff such other and further relief as justice requires.

William F. McInerny
Albert E. Jenner, Jr.
Samuel W. Block
Philip W. Tone
Wesley G. Hall
By /s/ William F. McInerny
/s/ Albert E. Jenner, Jr.
Attorneys for Plaintiff

Of Counsel:

Chapleau, Roper, McInerny
& Farabaugh
301-09 St. Joseph Bank Building
South Bend, Indiana 46601
233-5173

Raymond, Mayer, Jenner & Block
Suite 3300
135 S. La Salle Street
Chicago, Illinois
RAndolph 6-0220

PLAINTIFF'S EXHIBIT 26.

Dodge Manufacturing Corporation
Mishawaka, Indiana

July 24, 1967

Dear Fellow Shareholder:

A Special Meeting of Shareholders has been called for August 22, 1967, to consider and approve the merger of Dodge Manufacturing Corporation into The Reliance Electric and Engineering Company. Your Board of Directors on June 8, 1967 advised you of the terms of the Agreement of Merger.

It is important for you to know that this Agreement has now been amended to provide additional advantages to you as a shareholder of Dodge.

These additional advantages are as follows:

- Dividend Increased—the dividend on the new Reliance convertible preferred stock has been increased to $3.00 from $2.50 per share.
- Non-callable Period Extended—the new Reliance convertible preferred stock non-callable period has been increased to six (6) from five (5) years.
- Redemption Price Increased—the redemption and voluntary liquidation price on the new Reliance convertible preferred stock has been increased to $90 per share from $70 per share.

EXCHANGE TERMS: You will receive for each share of Dodge common stock one share of Reliance convertible preferred stock which will have a fixed cumulative annual dividend rate of $3.00 per share, payable 75c quarterly. In addition the new preferred stock will be convertible into 1.4 shares of Reliance common stock at any time and on a tax-free basis. The new Reliance convertible preferred stock will be non-callable for six years—until January 1, 1974. After that time it may be called but only at a price of $90 per share. Your Reliance convertible preferred stock will have full voting rights and will also have the power, voting as a class, to prevent the creation of any new Reliance preferred stock

ranking equal with or prior to this new convertible preferred stock. Application will be made for the listing of the new convertible preferred stock on the New York Stock Exchange.

TAX-FREE EXCHANGE: In the opinion of counsel, the exchange of your Dodge shares for the new Reliance convertible preferred will result in a tax-free exchange. Application for a tax ruling to this effect has been made and your Board of Directors intends to terminate the Agreement of Merger unless a favorable ruling is obtained.

PROSPECTS OF THE COMBINED COMPANIES: Reliance products are electrical, electronic and mechanical systems and equipment for driving, measuring, and controlling machinery and processes. These product lines will complement the Dodge lines. Reliance sells throughout the United States and has investments in technically qualified organizations in Switzerland, Japan, Mexico and Australia. Your directors and management believe that the combined management, technology and marketing capabilities of the merged companies will provide greater growth opportunities.

The Board of Directors and management have studied and considered carefully the new terms of the merger agreement and believe it to be the most advantageous offer to you as a shareholder. Therefore, your Board of Directors urges you, in your own best interest, to vote FOR the proposed merger with The Reliance Electric and Engineering Company.

A formal notice of meeting and proxy statement are enclosed, which we ask you to read carefully.

Since the approval of this proposal requires the consent of the majority of the outstanding shares, it is important that your shares be represented at this meeting. Failure to vote is the same as voting against.

We urge you to sign, date and mail the enclosed proxy promptly.

Sincerely,

/s/ J. A. MacLean
President

PLAINTIFF'S EXHIBIT 27.

Emerson Electric Co.
8100 Florissant Avenue
St. Louis, Mo. 63136

July 31, 1967

Dear Dodge Shareholder:

The Directors of Dodge are asking you, in effect, to sell your investment in Dodge for less than the best price available.

Two merger proposals are presently available to your Board of Directors. I believe the enclosed material demonstrates that if Dodge is merged with Emerson Electric Co., instead of with Reliance, you the Dodge shareholder will receive securities worth far more than those you would receive in the merger with Reliance. Further, our company is a substantially larger, more diversified company than Reliance, with a record of superior growth in net earnings and dividends.

The proposals provide that you exchange each share of your Dodge Common Stock for either one share of Reliance Convertible Preferred or one share of Emerson Convertible Preferred Stock. The value of these two securities must be compared.

	Emerson	Reliance
Annual Preferred Dividend Rate	$ 2.76	$ 3.00
Converted Market Value on July 28, 1967	$74.25	$61.25

In other words, your Directors are asking you to accept a merger proposal which is worth approximately $15,000,000 less at today's market than is the merger proposal Emerson offers you.

If you own 100 shares of Dodge Common Stock, based on closing common stock market prices on July 28, the converted market value of the Reliance offer would be $6,125 and the dividend you would receive would be $300 per year. The Emerson offer would result in a converted

market value of $7,425 and you would receive a dividend of $276 per year.

Do you realize that it would take over fifty years for the $24 of greater annual dividend from the Reliance offer to offset the $1,300 of greater market value of the Emerson offer.

Further, if the Emerson securities are sold at a later date, the added market value of the Emerson stock would be subject to capital gains tax while the $24 per year added dividend would be subject to ordinary income tax rates each year.

Just as important as an analysis of current values of the offers is an appraisal of the growth records of the two companies which back these offers:

* * * * *

[figures omitted]

Net sales, net earnings and earnings per share are shown as reported in the annual reports of Emerson and Reliance and without including pooled companies for years prior to their affiliation. Net sales for the companies acquired by Emerson in its successful program of selective diversification in this period were, in total, $138,885,000 computed as of the last full year of their respective operations prior to acquisition.

Based on these comparisons, do you feel that 24 cents per share of additional annual dividend offsets the $13 per share difference in converted market value at today's market and the difference in the established performances of Reliance and Emerson?

The exchange of the assets and business of your company is perhaps the most important step you as a shareholder can take. I urge you to give careful consideration to the enclosed material. Show it to your broker and ask his advice. The important thing is that ultimately you receive the most value in exchange for your investment in Dodge.

You as the Dodge Shareholder, not the Directors, control this important decision—and the resultant value you

will receive for your investment in Dodge. I urge you to vote AGAINST the Reliance merger and FOR the Emerson shareholder resolution.

Sincerely,

/s/ W. R. Persons
Chairman of the Board

Important Message to Shareholders of
Dodge Manufacturing Corporation

July 31, 1967

To the Shareholders of
Dodge Manufacturing Corporation:

Emerson Electric Co. (Emerson), owner of 152,282 common shares (13.2%) of Dodge Manufacturing Corporation (Dodge), is the largest single Dodge shareholder. We have previously asked you to withhold your vote on the proposed merger between Dodge and The Reliance Electric and Engineering Company (Reliance) recommended by the Dodge Board of Directors, until you heard from us.

The Dodge Directors mailed proxy material to you on July 24, 1967 submitting the Reliance deal. We do not think the Reliance merger is good for the Dodge shareholders. Emerson has made a merger proposal to the Dodge Directors which we believe is far more attractive and advantageous to Dodge shareholders than the Reliance deal. As set forth in the enclosed letter from W. R. Persons, Chairman of the Board of Emerson, the Dodge Directors are asking you to accept a proposal from Reliance which is worth approximately $15,000,000 less than Emerson's proposal at today's market. We think this matter is of such importance to you that you will want to read and consider the information set forth below. *Even though you may have signed and sent in the management proxy which solicited your vote in favor of the Reliance merger, you may sign and date the enclosed blue proxy which will revoke your prior vote and express your desire to be given the opportunity to choose between the two merger proposals.*

We solicit your proxy "AGAINST" the proposal which the Dodge Directors presented to you for a merger between Reliance and Dodge and "FOR" an Emerson shareholder resolution which evidences your desire to have an opportunity to consider the pending Emerson merger proposal, and calls upon the Dodge Directors to submit the Emerson proposal to you, as a shareholder, for your vote.

The Dodge Directors have not seen fit to provide you with the opportunity to choose between the two merger proposals available to your Company. Only by voting "FOR" the Emerson shareholder resolution and rejecting the Reliance merger proposal will you have the opportunity to express YOUR desire that this choice be given to you.

What Does the Emerson Proposal Offer?

Emerson on June 15, 1967, offered to enter into a merger agreement with Dodge, providing for a tax-free merger of Dodge into Emerson. The agreement has been executed by Emerson, approved by its Board of Directors, and formally presented to Dodge.

Under this agreement, each share of Dodge Common Stock would be exchanged for one share of a new Cumulative Convertible Preferred Stock, Series B, of Emerson. This Emerson Preferred would have an annual dividend rate of $2.76 per share, payable quarterly. It would be convertible at any time into .9 shares of Emerson Common Stock, and would be non-callable for six years. After six years, it would be callable at $86 per share, the call price declining at the rate of $1.00 each year for six years. The call price never reduces below $80. The Emerson Preferred will have full voting rights and will have the power, voting as a class, to prevent the creation of any other class of preferred stock ranking equal with or prior to the Emerson Preferred.

In order to avoid inequity to former Dodge shareholders who tendered stock to Emerson under its earlier tender offer, Emerson will offer to each such Dodge shareholder the right to purchase, after consummation of the Dodge-

Emerson merger and upon repayment to Emerson of the net price paid for his tendered shares, such number of Emerson Preferred shares as the Dodge shareholder would have been entitled to receive in the merger if he had not tendered his shares to Emerson.

In order for you to be fully informed of the details of Emerson's merger proposal, we are enclosing, as "Supplemental Information for Dodge Shareholders," a copy of the proxy statement we sent to our own shareholders, in soliciting their proxies for a special shareholders meeting on August 18, 1967, called to approve the Emerson-Dodge merger. Our offer is a firm offer, subject to the same type of shareholder approval required for the Reliance offer.

Reliance Changes Its Deal

The Dodge Directors announced on May 25, 1967, that they had signed a merger agreement with Reliance. This agreement provided that each share of Dodge Common Stock would be exchanged for a new Reliance Preferred Stock, having an annual dividend rate of $2.50 per share, into 1.4 shares of Reliance Common Stock, non-callable convertible into 1.4 shares of Reliance Common Stock, non-callable for five years, and thereafter callable at $70.

On July 14, 1967, Emerson wrote to you stating that it believed Emerson's offer to be far more attractive and advantageous than the proposed deal with Reliance. Emerson stated, "We do not think it is a good merger for Dodge."

After our letter, Reliance and the Dodge directors made a *new* deal. Under this proposal, which will be voted on at the August 22 meeting, each share of Dodge Common would be exchanged for a new Reliance Preferred having an annual dividend rate of $3 per share, convertible into 1.4 shares of Reliance Common, non-callable for six years and thereafter callable at $90. Dodge management has recommended this changed proposal as providing additional advantages. Are the so-called advantages of any real significance to you?

Call Price. The call price of the Reliance Preferred has been increased from $70 to $90. In point of fact, if Reliance were to call this Preferred Stock the day after it was issued, it would require a disbursement of over $101,000,000 or *$27,000,000 more than the total combined shareholders' equity on a pro forma basis* of Reliance and Dodge as of April 30, 1967. Reliance has no obligation to call this Preferred Stock at $90, and you may well question whether this increase of $20 in the call price changes in any way the real value of this security to you.

Redemption Period. Reliance has increased the period during which its Preferred Stock will be non-callable from five to six years. This is a patent attempt to match one feature of the superior Emerson offer.

Dividend. Finally, *after* Emerson's offer, Reliance has changed the dividend on its proposed Preferred Stock to increase it by 24¢ per year per share above the Emerson dividend rate. This 2¢ per month change in no way bridges the gap of $15,000,000 in present market value between the two proposals.

These changes in the Reliance deal appear to be an effort on the part of the Dodge and Reliance directors to put together a deal which might seem to approach the values offered to you by Emerson. The value of the security offered by Emerson, measured upon either an historic or a current basis, greatly exceeds the value of the Reliance offer.*

The Reliance Preferred Stock has other features which the Dodge Directors have not seen fit to stress. In a footnote on page 9 of the management proxy statement, it is noted that the Reliance Preferred Stock will receive

---

* Market prices of Emerson's Common Stock are set forth on page 7 of the enclosed Supplemental Information to Dodge Shareholders. Market prices of Reliance are set forth on page 14 of the proxy material the Dodge Directors mailed to you, which omitted any reference to Emerson's market prices.

a preference in case of the involuntary liquidation of Reliance of $20 per share. The $20 liquidation value is $70 less than the call price which Reliance has placed on its Preferred Stock. Emerson's Preferred Stock has a preference on liquidation of $80 per share or *four times* that of Reliance. This liquidation value is the ultimate measure of the extent to which the assets of the company are pledged behind the security of the stock, a significant indicator of the safety of the preferred stock.

Emerson's Offer is a Firm Commitment

Dodge management has persistently attempted to create the impression that the Dodge-Reliance deal is a firm agreement and is the only one which you may consider. They have even gone so far as to indicate that if any resolution relating to Emerson's merger proposal is presented to you at the meeting, they intend to rule it out of order.

You may well ask why the Dodge Directors are so apprehensive of the outcome of a free choice by you that they refuse in advance to entertain any expression of that choice at an open meeting. We ask you if this is a fair way of determining what you as a shareholder want.

You should carefully note, moreover, that *Reliance can walk away from the Dodge-Reliance merger even after shareholder approval if, "in their reasonable judgment" the merger appears inadvisable* because of the number of shareholders who dissent and demand cash for their shares. This "out" is not related to any fixed standard, but is purely discretionary.

Also, under Indiana law, Dodge management can refuse to approve consummation of the merger even after you vote, for whatever reason they deem sufficient. As stated in the Dodge proxy material, this "reapproval cannot take place until 30 days after" [the shareholders vote]. Emerson's proposal is a firm one and will be open to you after you reject the Dodge-Reliance deal.

We will vote our shares of Dodge stock against the Reliance proposal and in favor of the Emerson shareholder

resolution. We are going to watch the situation carefully and make such changes in our stock holdings and in our proposal as we deem desirable. *We pledge, however, that the merger proposal which Emerson has made to the Dodge Directors will be available after you reject the Reliance proposal on August 22nd.*

Dodge Has No Legitimate Grounds for Questioning the Tax-Free Nature of Emerson's Offer.

Dodge management seeks to cast doubt upon the tax-free nature of the Emerson proposal. Emerson has received unequivocal advice from experienced tax counsel that its merger offer to you qualifies as a tax-free transaction. Against this unqualified advice, Dodge offers a suggestion of its lawyers that the tax-free nature of the Emerson proposal "may be" in doubt. The tax-free nature of the Emerson proposal is no more "in doubt" than that of the Reliance proposal. The Reliance proposal must be presented to the Internal Revenue Service for a ruling that the merger and the exchanges of stock thereunder will be tax-free. That merger would not become effective unless such a ruling is obtained.

Emerson presented its merger proposal to the Dodge Directors with no conditions at all. From the very first, on June 15, 1967, it has been referred to as "a tax-free merger" of Dodge into Emerson. When the Dodge Directors turned down the Emerson merger proposal, they did not say they had "doubt" of its tax-free nature. They did not offer to accept it subject to a favorable tax ruling. They said only, that, having "approved an agreement of merger with Reliance," the Dodge Board "is not in a position *at this time* to act upon the proposed agreement," which Emerson had sent Dodge.

Why Is the Emerson Offer More Attractive Than the Reliance Offer?

If the Emerson merger had been consummated July 28, the dollar value of each preferred share received from Emerson in the merger and immediately converted into

an Emerson common share would have been $74.25. On that same day, the dollar value of a Reliance preferred share received on the merger that the directors recommend to you similarly converted into Reliance common shares would have been $61.25.

In other words, the dollar value of the Emerson preferred shares offered in the merger would have been 21% higher than the dollar value of the Reliance preferred shares which your directors want you to accept. What does this mean in dollars? It means that the Dodge Directors want you to accept a merger proposal *worth today* $13 per share less than the Emerson proposal!

Why Is the Emerson Merger Better for You As a Dodge Shareholder?

We suggest that you consider carefully the history of the growth of Emerson, and the growth in the value of its stock, in determining what action you will take. The following data, we believe, will demonstrate to you the desirability of sharing in that growth.

1. Emerson Provides Growth Strength Through Selective Diversification.

Emerson is one of the outstanding growth companies in the USA today, as evidenced by its performance record:

* * * * *

[Figures omitted]

The policy of Emerson with all merger partners is to continue to operate each merged company as an autonomous Division. If the merger is consummated with Dodge, Emerson intends to maintain Dodge's principal operations in their Mishawaka-South Bend location and to continue substantially Dodge's present policies, practices and employments.

2. Emerson's Shareholders' Equity Provides Greater Security for a Preferred Shareholder.

The shareholders' equity in the combined company following a merger [pro forma net worth] is important to the shareholders of the absorbed company. It is *another* measure of strength available in case of economic adversity. In this regard, the following comparison is important:

Pro Forma Shareholders Equity*

Reliance-Dodge	Emerson-Dodge
$74,567,000	$177,336,000

There is 2.3 times more shareholders equity in an Emerson Dodge merger!

3. Emerson Earnings and Dividends Have Grown Steadily.

Emerson is a substantially larger company than Reliance, is engaged in diversified businesses, and has demonstrated an earnings and dividend record consistently superior to that of Reliance. The strength of Emerson's selective diversification avoids the cyclical declines of the more restricted Reliance markets as set forth graphically herein.

Emerson's net earnings per common share have increased steadily and cash dividends on common stock have kept pace.

Increase Per Common Share on a Percentage Basis Over 1957

* * * * *

[Graphs omitted]

---

* As of April 30, 1967. The financial information concerning Dodge herein has been obtained from reports filed with the Securities and Exchange Commission and other materials published by Dodge. Other information relating to Dodge and included herein has been obtained from public documents and from reports published by Dodge. The information with respect to Reliance has been obtained from similar reports, public documents and other material.

These graphs show the percentage of increase in each year since 1957 in earnings and dividends paid per common share.

Net earnings are computed from the annual reports of the respective companies and without including pooled companies for years prior to their affiliation. They, therefore, vary from net earnings reported on a pooled basis in the proxy material of Emerson included herewith as "Supplementary Information for Dodge Shareholders."

Why Should You Vote "Against" the Reliance Merger and "For" the Emerson Shareholder Resolution?

We feel you should be given the right to decide whether the Emerson merger or the Reliance merger offers you the greater economic benefit. However, the Dodge management and directors have refused to give you an opportunity to vote on the Emerson proposal at your August 22d meeting. We asked for a shareholders list in order to write to you. Our request was turned down and not until we instituted law suit to obtain such a list were we finally given it.

To provide you with an opportunity to express *your* desire to choose which merger *you* want, we intend to submit at the special meeting of Dodge shareholders which has been called for August 22, 1967, the following resolution:

> Resolved, that a majority of the shareholders of Dodge Manufacturing Corporation desire the opportunity to consider the agreement of merger proposed to be entered into between Emerson Electric Co. and Dodge Manufacturing Corporation, and hereby call upon the Directors of the corporation, acting as a Board of Directors, to take all action necessary and appropriate pursuant to the provisions of Article 4 of Part 2 of the General Corporation Act of the State of Indiana, to approve and cause to be submitted to the shareholders of Dodge Manufacturing Corporation such agreement of merger.

If you agree with our position that the Emerson proposal offers you greater economic advantages than the Reliance proposal, or if you agree that you should be given an opportunity to exercise a choice, you are respectfully urged to date, sign and return the accompanying proxy, voting by marking the box "AGAINST ☒" the Reliance merger proposal and "FOR ☒" the Emerson shareholder's resolution calling upon the Dodge Directors to submit the pending Emerson merger proposal to you, as a shareholder, for your vote.

The Emerson Dodge merger is a desirable one.

Dodge cannot say that Emerson is a less "well-suited" merger partner for Dodge "as to products, markets, personnel and objectives." The Dodge Directors tell you that in 1966 Emerson and Dodge "discussed various proposals by which Emerson might acquire the business and assets of Dodge in exchange for stock." *The Dodge Directors even made a counter-proposal of merger.* They could not have had any concern about the future growth of Emerson, which in the past has far outstripped the growth of Reliance.

The Dodge Directors have given three reasons for recommending the Reliance proposal. The same reasons apply with greater force to the Emerson proposal:

> Immediate and substantial increase in dividend rate. So in Emerson's.
>
> Preferential right in earnings to assure dividend continuance. So in Emerson's.
>
> Option to convert to participate fully in future growth. So in Emerson's.

The real issue for *you* to decide is whether you want to "give careful consideration" (as the Dodge Directors say they did) to "many factors" including:

> Market prices—As of July 28, 1967, the Emerson offer provided a converted market price which is $13.00, or 21% above the Reliance offer for the Common Stock into which the Preferred could be converted.

Earnings and dividends—The earnings and dividends per share are set forth on the graphs above.

Emerson's earnings are 282% per share above their 1957 base, Reliance 29%.

We believe *you* should have a chance to "give careful consideration" to the many factors with these facts before you. You should not have to accept another's judgment on this, someone whose judgment may have been affected by promises *he* received.

On June 13, 1967, five days after the Dodge Board approved the Reliance merger proposal, they report that they entered into employment contracts with six of Dodge's officers, including J. Allen MacLean. These contracts "provide for the employment of the officers for one or two-year periods at their present base rates of compensation, with eligibility to participate in other compensation and benefit plans and arrangements available to executive employees generally." *These contracts are to be assumed by Reliance in the merger.* One may ask if these contracts were discussed in connection with the Reliance merger negotiations, and ask why in the midst of a fiscal year, the Directors felt it necessary to provide job security for Mr. MacLean and the other five officers.

The Dodge Directors have told you about the lawsuit which Emerson brought to obtain a court order assuring you of the choice which we feel you should have, and of an adverse ruling, which we are now appealing. Pending that appeal, *only your votes can assure that choice.* It is to be noted, however, that on July 24, 1967, after the institution of our lawsuit and the ruling which the Dodge Directors refer to, Mr. John R. Wood, Jr., one of your Directors, a member of the Dodge Executive Committee, and chief financial officer of a major United States corporation, resigned from the Dodge Board. The management of Dodge reports that Mr. Wood, who is an outside Director, resigned because of a disagreement with the Dodge management's handling of that lawsuit.

Information Required in Proxy Statement

Your attention is called to the fact that the cost of solicitation by Emerson will be borne by that corporation. Proxies will be solicited by mail and may also be solicited by officers, directors and regular employees of Emerson. In addition, Emerson has engaged Georgeson & Co. and Kissel-Blake, of New York, New York, to assist in the solicitation of proxies by personal interview, mail, telephone and telegraph. We will reimburse brokerage firms, bankers, trustees, nominees or other persons for their out-of-pocket expenses in forwarding proxy material to the beneficial owners of shares held in their respective names. Total expenditures for solicitations to date have been approximately $6,000 and total amount to be expended is estimated at $30,000.

Any shareholder giving the accompanying proxy has the right to revoke it and said revocation will be effective when notice of it is given to the Secretary of Dodge. It should be noted that a later dated proxy will revoke a previously executed proxy. All shares represented by the accompanying proxy, if properly executed, duly returned to Emerson and not revoked prior to the meeting will be voted in accordance with the specifications made in the proxy. If no instructions are given with respect to the matter voted upon, shares represented by this proxy will be voted against the merger of Dodge into Reliance and in favor of the Emerson shareholder resolution. Emerson knows of no matters to come before the meeting other than those specified above. However, if other business should properly come before the meeting, the persons voting your proxy will vote it in accordance with their best judgment. This proxy material has been prepared and the proxies designated at the direction of the Board of Directors of Emerson.

Emerson Electric Co.
W. R. Persons
Chairman of the Board

You are entitled to revoke any proxy given to Dodge management by signing the enclosed blue proxy and dating it later than any proxy given to Dodge management.

PLAINTIFF'S EXHIBIT 28.

Dodge Manufacturing Corporation
Mishawaka, Indiana

August 4, 1967

Dear Fellow Shareholder:

Your Board of Directors strongly supports the Reliance offer rather than the Emerson offer because it is better and more advantageous to you as a Dodge shareholder.

You should know that your Board arrived at this decision with the assistance of the investment banking firm of Dillon, Read & Co. Inc., 46 William Street, New York, N. Y., and after thoroughly evaluating the terms of both offers.

The important reasons underlying this decision are as follows:

1. Preferred Stock Dividends: The Reliance offer provides a $3.00 annual dividend versus $2.76 under the Emerson offer. This higher dividend not only gives you more yearly income but provides solid support against the possibility of substantially lower common stock prices affecting the market price of convertible preferred stocks.

2. Earnings Per Share: Under the Reliance offer Dodge earnings per share after conversion would increase to $3.70 per share from the $3.52 earned by Dodge in fiscal 1966. *Under the Emerson offer Dodge earnings of $3.52 would decrease to $2.77 per share after conversion or a decrease of 21%.*

In their letters of July 31st, Emerson did not tell you about this decrease in earnings per share of $.75,

or a loss in earnings to Dodge shareholders of over $800,000.

3. Future Prospects: Your Board of Directors and management believe that Reliance's earnings prospects and growth rate for the immediate future are better than Emerson's. You as a shareholder of Dodge are naturally interested in this future growth.

A realistic and sound basis for evaluation of recent performance can be made from a comparison of the latest five year record of both Reliance and Emerson in the following table:

* * * * *

[Figures omitted]

As you can see Reliance performance is superior in every category.

4. Book Value Per Share: Under the Reliance offer the book value of each Dodge share after conversion increases from the present $19.76 to $23.06, up 17%. *Under the Emerson offer the shareholder suffers a dilution in book value per share after conversion from $19.76 to $15.77, down 20%.*

Emerson in their July 31st letter, did not tell you about this loss in book value to Dodge shareholders of $4,600,000.

5. Call Price: The Reliance offer provides for a call price of $90.00 per share whereas the Emerson offer has an $86.00 call price. Furthermore, the Emerson call price is reduced $1.00 per year after the seventh year eventually to $80.00.

The call price is a valuable feature of the Reliance offer because it assures the shareholder that the $3.00 preferred dividend can not be taken away from the Dodge shareholder unless he is paid $90.00 per share, or exercises his right to convert into common shares.

6. Dividends on Conversion: Under the Reliance offer, after conversion, the underlying annual dividend rate is equal to $1.68 per Dodge common share.

Under the Emerson offer, after conversion, the corresponding dividend rate is only $1.51 per share or 10% lower.

7. Converted Value: On August 2, 1967 the Reliance offer had a converted market value of $65.98 and the Emerson offer had a converted market value of $78.64. However, this differential in converted value is subject to market fluctuations.

Your Board of Directors believes that present converted value difference is easily outweighed by the solid investment advantages of the Reliance offer.

Again, in their July 31st letter, Emerson did not tell you of the susceptibility of their offer to market fluctuations.

8. Tax Free Transaction: Your Board has been advised by counsel that no merger should be consummated unless a favorable tax-free ruling has been received from the Internal Revenue Service prior to the closing. Counsel is of the opinion that such a tax-free ruling will be received in the Reliance offer but has further stated that it is doubtful that a tax-free ruling could be obtained with respect to the Emerson offer.

Clearly, it is in the best interest of Dodge shareholders to accept the non-taxable Reliance offer.

Considering Reliance's excellent five year record, its future prospects and the non-taxable nature of the transaction your Board of Directors is of the opinion that a greater opportunity exists for Dodge shareholders by accepting the Reliance offer.

Your Board of Directors and management strongly recommend that you vote FOR the proposed Dodge-Reliance merger. *To be sure that your vote is counted in favor of this proposal, please sign, date and mail only the enclosed WHITE management proxy.*

Sincerely,

/s/ J. A. MacLean
President

PLAINTIFF'S EXHIBIT 29.

Emerson Electric Co.
8100 Florissant Avenue
St. Louis, Mo. 63136

August 4, 1967

Dear Dodge Shareholder:

Emerson Electric Company is the largest single Dodge shareholder. Emerson opposes the Reliance merger which the management of Dodge has submitted to the Dodge shareholders. We do not believe it is the best one available. Emerson has submitted its own merger proposal which we believe is far superior to the Reliance deal.

The Dodge directors have refused to consider the Emerson proposal and have put forth many legal obstacles to its consideration by the Dodge shareholders. In a recent letter to the Dodge shareholders, Dodge management attempted to cast doubt upon the tax-free nature of the Emerson proposal. THERE IS NO MORE DOUBT ABOUT THE TAX-FREE NATURE OF THE EMERSON PROPOSAL THAN THERE IS ABOUT THE RELIANCE PROPOSAL. At this point each stands only on the opinions of the counsel for the respective companies.

To clear up any doubt regarding the tax-free nature of Emerson's proposal, we have attached to this letter the opinions of the general counsel of Emerson and of its special counsel. These opinions state unequivocally that the merger of Dodge into Emerson would be a tax-free merger under applicable provisions of the Internal Revenue Code. Dodge and Reliance say no more.

In our letter to you of July 31, 1967, we made the following pledge:

> "The merger proposal which Emerson has made to the Dodge Directors will be available after you reject the Reliance proposal on August 22."

THE EMERSON MERGER PROPOSAL IS A FIRM ONE. Why is it that, in the Reliance proposal, RELIANCE CAN

WALK AWAY FROM ITS MERGER should you, the Dodge shareholders, approve it, if in the "reasonable judgment" of the Reliance Board, the merger appears inadvisable? No set standards are furnished. The Dodge and Reliance Boards of Directors have not indicated in any way what percentage of dissenters would upset their deal. This is contrary to what appears in many merger agreements, including that offered by Emerson. In the Emerson agreement the merger may be terminated because of dissenters *only* if, by reason of the election of the Dodge stockholders to take dissenter's rights, or otherwise, the holders of less than 51% of the Dodge stock (excluding any shares of Dodge owned by Emerson) will receive the Emerson preferred stock on the merger exchange.

The Dodge Directors refused to approve the Emerson proposal on the ground that, having approved an agreement of merger with Reliance, they were "not in a position" to consider the Emerson proposal. After you reject the Reliance proposal, the Dodge directors will be in a position to submit the Emerson merger proposal promptly.

If you have previously voted in favor of the Reliance merger, you may revoke that vote by signing, dating and returning the enclosed Emerson BLUE proxy. Be sure to indicate by checkmark your vote "AGAINST" the Reliance merger, which is the first item, and "FOR" the Emerson proposal, which is the second item on the proxy card, and date the proxy card. You have every right to change your mind. Only the latest dated proxy counts.

Sincerely,

/s/ W. R. Persons,
W. R. Persons
Chairman of the Board

[Attachments omitted]

PLAINTIFF'S EXHIBIT 30.

Emerson Electric Co.
8100 Florissant Avenue
St. Louis, Mo. 66136

August 10, 1967

Dear Dodge Shareholder:

On August 4, 1967, J. Allan MacLean, President of Dodge, wrote to you urging that you accept the Reliance merger offer rather than the Emerson offer. Mr. MacLean attempted to assess your "future prospects" as a shareholder of Reliance or Emerson. He compared the sales and earnings of Reliance and Emerson respectively in 1962 and 1966 as a *"realistic"* and *"sound"* approach. This approach is in fact *Unrealistic* and *Unsound.*

Mr. MacLean did not select 1962 as a base year by pure accident. Rather, the year 1962 represents the lowest net earnings per share of Reliance during the past ten years, a year from which one would expect some major improvement.

For example, five years earlier, in 1957 Reliance earned $2.09 per share, almost equivalent to its current level of earnings. The net sales and net earnings of Emerson and Reliance respectively in *each* of the past ten years are as follows:

* * * * *

[Figures omitted]

You may well question whether Dodge management is being candid with you in suggesting that the "future prospects" of Reliance can in any sense compare with those of Emerson.

The market place is the best judge of the worth of a security and market price is the best evidence of its value and "future prospects". Each share of preferred stock which Emerson offers you for each Dodge share, converted as of the close of the market on August 4, was worth $81.56. Each share of preferred stock Reliance

offers you had a value on the same basis of only $64.40. *This is how the market evaluates the "future prospects" of the two companies.*

The following chart reflects the respective high and low market values of Reliance and Emerson common shares during each of the years since 1957. Even taking Mr. MacLean's five year period for comparison, Emerson's common stock has consistently out performed Reliance in terms of market value.

* * * * *

[Graph omitted]

Mr. MacLean says Emerson failed to tell you that these market values may "fluctuate". Market values do fluctuate. In fact, in the two weeks prior to Mr. MacLean's letter, this "fluctuation" has increased the spread in favor of the Emerson proposal from $13.67 per share (July 21) to $17.16 per share (August 4).

There can be no question that your directors considered Emerson a good merger partner. They even made a merger proposal earlier this year.

Mr. MacLean gives as an "important reason" for favoring the Reliance deal the fact that it pays 24¢ a year more in dividends per share than the Emerson proposal.

1) With a difference in effective market value as of August 4, 1967 of $17.16 per share, it would take you seventy years to catch up at 24¢ per year.

2) Do you want to wait seventy years to catch up? Even in seventy years you may not come out whole since the 24¢ a year is taxable currently at ordinary income tax rates. The $17.16 spread would not be taxable unless or until the stock was disposed of and then the tax would be at capital gains rates.

3) If in the meantime the company had to be liquidated on some involuntary basis, the value of the Reliance Preferred stock is fixed at $20.00 a share while the value of the Emerson preferred stock is $80.00 a share.

In our first letter to you, we stated:

"The directors of Dodge are asking you, in effect, to sell your investment in Dodge for less than the best price available."

This statement is even more true today than it was on July 31, 1967. It will continue to be true until you reject the Reliance proposal and call upon your directors to give you the opportunity to obtain the best price available for your investment in Dodge. Do not make a costly mistake. Rely on the facts. Vote the BLUE proxy "For" the Emerson shareholder resolution and "Against" the Reliance merger proposal.

You are urged to sign, date and return the enclosed BLUE proxy. If you have already returned a white proxy to Dodge, your signing the BLUE proxy on a later date will revoke it, and your vote will be cast in accordance with your wishes.

Sincerely

/s/ W. R. Persons
W. R. Persons
Chairman of the Board

PLAINTIFF'S EXHIBIT 31.

Emerson Electric Co.
8100 Florissant Avenue
St. Louis, Mo. 63136

August 16, 1967

To the Shareholders of
Dodge Manufacturing Corporation:

The special meeting of Dodge shareholders is just a few days away. This may be your last opportunity to express by proxy your preference between a Dodge-Emerson merger and a Dodge-Reliance merger.

The officers and directors of Dodge have decided to change Dodge from a small independent company to a

part of a larger organization. The decision you must make as a Dodge shareholder is whether you would have greater value from Emerson shares or Reliance shares.

As in all major decision-making, there are only a few key issues:

1. The first issue is the immediate value you will receive for your Dodge shares. On August 16th, the converted market value of the Emerson preferred was $16.19 more per share than the converted market value of the Reliance preferred. Measure this difference in current market value against the 24¢ in extra annual dividend per share offered by Reliance.

2. The second issue is the future growth in market value of Emerson shares as compared with Reliance shares. In looking at the future, the recent past is an excellent guide. The increase in market value of Emerson shares since 1957 has been 5.6 *times* the increase in market value of Reliance shares.

3. The third issue is the tax-free aspect of the merger. We have advised you that the Emerson merger proposal will be available to you after the August 22nd meeting on a tax-free basis. Emerson has applied for a tax ruling and, like Reliance, anticipates that the ruling will be favorable. If for any reason the Emerson merger should not receive a "tax-free" ruling, the Dodge management would be fully and legally authorized to refuse to consummate that merger, just as it is authorized to refuse to consummate the Reliance merger.

You will receive greater value for your Dodge shares by voting for Emerson. Time is short. Vote AGAINST the Reliance deal and FOR the Emerson resolution on the enclosed Blue Proxy. Only the latest dated proxy counts.

Very truly yours

/s/ W. R. Persons
W. R. Persons
Chairman of the Board

PLAINTIFF'S EXHIBIT 33.

Proxy statement dated November 15, 1967, issued by Reliance Electric Co. in connection with merger of Toledo Scale Corporation into Reliance.

* * * * *

GENERAL INFORMATION

On June 16, 1967 Emerson Electric Company ("Emerson") acquired 152,282 shares of Common Stock of Dodge Manufacturing Corporation ("Dodge") representing more than 10% of the outstanding shares of Dodge. Those shares were acquired pursuant to an invitation for tenders at a price of $63, with a 90¢ brokers' commission. Emerson has advised Reliance that, although definitive computations have not been made, Emerson's costs and expenses incurred in connection with the tender offer were such that the total cost per share to Emerson was substantially in excess of $63.90.

On August 28, 1967 Emerson sold 37,000 of its Dodge shares on the New York Stock Exchange at a price of $68 (before commission and other expenses of the sale) thereby reducing its holdings to less than 10% of the outstanding shares of Dodge. If Emerson did in fact realize profits on such sale, such profits may be recoverable by Reliance (as successor by merger to Dodge) under Section 16(b) of the Securities Exchange Act of 1934. Emerson has asserted that the profits, if any, realized upon such sale are not recoverable by Reliance under Section 16(b) as a matter of law, and Emerson has advised that it will resist any suit brought to recover alleged profits. Reliance believes that, on the basis of information presently available, Emerson may have realized some profit on such sale recoverable under Section 16(b). Reliance has not yet determined whether to bring litigation to recover any such profit. Such a determination will depend upon a review of all relevant factors, including the net amount of any profits that might be established, the likelihood of recovering such profits in the light of legal defenses that might be asserted by Emerson, the avowed intention of Emerson to

resist any attempt at recovery, and the cost, expense and management time required in connection with any such litigation.

On September 13, 1967 Emerson sold 115,282 Dodge shares to Dodge at a price of $69 per share. Reliance does not believe that Section 16(b) is applicable to such sale since Emerson was not then the holder of 10% or more of the outstanding shares of Dodge. Counsel for Emerson furnished its opinion to that effect and counsel for both Reliance and Dodge concurred in that opinon.

* * * * *

No. 68 C 87 (3).

IN THE UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF MISSOURI, EASTERN DIVISION.

EMERSON ELECTRIC CO.,

Plaintiff,

vs.

RELIANCE ELECTRIC COMPANY,

Defendant.

MEMORANDUM OPINION.

(Filed September 18, 1969.)

In this case, tried to the Court, plaintiff seeks a declaratory judgment concerning its liability, if any, to defendant for profits realized on the sale of certain stock. Defendant has counterclaimed for the amount of the profits. The issue of profits has been postponed pending the resolution of the issue of liability. We have diversity jurisdiction.

For determination is the construction and application of Section 16(b) of the Securities Exchange Act of 1934 (Section 78p(b), 15 U.S.C.) to the peculiar facts of this case. Most of the essential facts have been stipulated. On May 22, 1967, Emerson Electric Company invited tenders of up to 550,000 shares of Dodge Manufacturing Corporation common stock at a price of $63, reserving the right to purchase all shares tendered. As extended, the tender offer expired June 16, 1967. At that time, Emerson elected to purchase all of the tendered shares, a total of 152,282. These shares constituted 13.2% of the outstanding Dodge common stock. Prior to June 16, 1967, Emerson did not own any shares of Dodge common stock.

Shortly before the stock acquisition by Emerson, Dodge and Reliance Electric & Engineering Company (now Reliance Electric Company) had entered into an

agreement whereby Dodge was to be merged into Reliance. Emerson sought to prevent the merger, which needed stockholder approval, advocating instead a merger with Emerson. A stockholders' meeting to consider the merger proposal was called for August 22, 1967. A proxy fight ensued, the result of which was victory for Reliance. Shortly thereafter, but prior to the final approval of the merger by the Dodge directors, Emerson sold its Dodge holdings. It first sold 37,000 shares at $68 a share on August 28, 1967 to Goldman, Sachs & Company, investment brokers. Then, on September 11, 1967, it sold the remaining 115,282 shares at $69 to Dodge. Concededly, Emerson realized a substantial short-term profit on these sales even after deducting all of its expenses of purchase and sale.

Section 16(b) provides, inter alia, that any profit realized by the beneficial owner of more than 10% of certain equity securities from the purchase and sale (or sale and purchase) within any period of less than six months shall inure to and be recoverable by the issuer. The statute further provides:

> "This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved * * *."

The initial question for determination is whether Emerson was a beneficial owner of more than 10 per cent of Dodge common stock "at the time of the purchase" of such stock. Emerson states the question thusly: "Should the very purchase by which one, who prior thereto owns no securities of an issuer, becomes a 10% owner be counted in determining liability for insider short-swing profits?" It argues that in the context of the Act, the words "at the time of purchase" can mean only "before the purchase" and that since Emerson owned no Dodge securities prior to June 16, 1967, and had no access of "inside" information, it may not be subjected to Section 16(b) liability. We do not agree.

Passing for the moment Emerson's further contention that its acquisition of the stock was not a "purchase" within the meaning of the Act, we are convinced that "at the *time* of purchase" includes the time "simultaneously with" the purchase, so that a shareholder becomes subject to the provisions of Section 16(b) immediately upon (that is, at the very moment of) his acquisition of more than 10 per cent of the corporation's stock. This construction accords not only with the literal meaning of the language, but more importantly, best serves to effectuate the legislative purpose manifest in Section 16(b). Accord: *Stella v. Graham-Paige Motors Corporation,* D.C.N.Y., 104 F. Supp. 957, affirmed (on this point) 2 Cir., 232 F.2d 299, cert. den. 352 U.S. 831. See Cook & Feldman, Insider Trading Under the Securities Exchange Act, 66 Harvard Law Review 612, 631-632.

Emerson urges, however, that although the transaction by which it acquired more than 10 per cent of Dodge stock was in fact a "purchase" (and indeed, under any view, a cash acquisition of this nature, could not be otherwise) nevertheless it was not a "purchase" of the kind contemplated by Section 16(b). Its theory is that each case must be examined on its own peculiar facts (*Petteys v. Butler,* 8 Cir., 367 F.2d 538), and that since the only evidence of record is to the effect that Emerson had no access to and had not acquired "insider" information prior to the purchase, its acquisition of a 13.2 per cent interest was not one that could have lent itself to the practices Section 16(b) was enacted to prevent. Again, we do not agree.

We do not believe that Congress intended to exclude any transaction which is undeniably a purchase under any concept thereof. In the cases in which the facts were examined by the courts, the issue was whether a particular transaction which did not involve a purchase (or a sale) within the ordinary understanding of those terms, e.g. conversions and reclassifications of stock, was a purchase (or a sale) as defined by Section 3 of the Act. It was to aid in resolving problems of that nature that the courts

have created the following test or standard: "Every transaction which can *reasonably be defined as a purchase* will be so defined, if the transaction is of the kind which can possibly lend itself to the speculation encompassed in Section 16(b)" *Ferraiola v. Newman*, 6 Cir., 259 F.2d 342, 345. This is the test applied by the Eighth Circuit. *Petteys v. Butler*, 8 Cir., 367 F.2d 568.

Petteys involved a conversion transaction and the Court held that under the "unique facts" of that case the conversion of convertible preferred stock to common stock by non-controlling directors was not a purchase within the purview of the Act even though it might "represent a type of exchange of equivalents that can be read into a literal interpretation of the § 16(b) language of 'otherwise acquire' and 'otherwise dispose of'." What *Petteys* ruled is succinctly summarized by Judge Gibson as follows (367 F.2d, l. c. 356): "If no purpose is served by attaching the *artificial label* of 'purchase' to a transaction, when it has *none of the common indicia* of a purchase, no such label is demanded, nor will one be attached. This, we believe to be the correct law and it is the law to be applied by us to the facts of this case."

In the instant case, no artificial label of "purchase" is attempted. The transaction by which Emerson acquired the Dodge stock has all the "common indicia" of a purchase. Here, we do not have an "otherwise acquire" situation, but rather, a simple, conventional acquisition of stock for cash.

We hold that the transaction was a purchase under any view of the facts. By such purchase, Emerson "elected to become a statutory fiduciary," thereby becoming subject "to the disciplinary purpose of § 16(b)", *Western Auto Supply Company v. Gamble-Skogmo, Inc.*, 8 Cir., 348 F.2d 736, regardless of the actual availability or use of inside information. The possibility of insider abuse is inherent in every such transaction. The expressed purpose of the statute is to prevent the unfair use of information which *may* have been obtained by the beneficial owner. Clearly, Section 16(b) is applicable to Emerson's

August 28, 1967 sale for cash of 37,000 shares of Dodge stock.

The basis on which Emerson disclaims liability as to said sale is that it was "forced" to dispose of these shares because of the foregone conclusion that the Dodge-Reliance merger would be approved very shortly with the result that the consummation of the merger would, so it is claimed, be treated as a sale of the Emerson-held Dodge shares in exchange for shares of Reliance. We are not convinced that the exchange of shares incidental to the merger would necessarily involve a "sale" of the Dodge stock held by Emerson. The cases cited by Emerson on this point go no further than to hold that for purposes of the *anti-fraud* provisions of the Act, the acquisition of new stock for the old, resulting from a statutory merger, is deemed a purchase and sale. *Dasho v. Susquehanna Company,* 7 Cir., 380 F.2d 262. And see *SEC v. National Securities, Inc.,* 393 U.S. 453. Thus, in the *SEC* case, the Supreme Court noted that the meaning of particular phrases in statutes must be determined in context and that the same words may take on a different coloration in different sections of the securities laws. The Court stated, "We must therefore address ourselves to the meaning of the words 'purchase or sale' in the context of § 10(b). Whatever these or similar words may mean in the numerous other contexts in which they appear in the securities laws, only this one narrow question is presented here." And again, "Whatever the terms 'purchase' and 'sale' may mean in *other* contexts, here an alleged deception has affected individual shareholders' decisions in a way not unlike that involved in a typical cash sale or share exchange. The broad anti-fraud purposes of the statute and the rule would clearly be furthered by their application to *this* type of situation."

Hence, it is not at all certain that in the context of Section 16(b) the word "sale" would be construed to include the involuntary exchange by Emerson of the Dodge shares for those of Reliance pursuant to the merger. Inasmuch as such a transaction is an "otherwise dispose

of" situation, and not a typical or conventional sale, the rationale of *Petteys, supra,* would undoubtedly require an examination of the "unique" facts of the case to determine whether the purposes of Section 16(b) would be furthered by attaching the artificial label of "sale" to this type of situation. However, we need not decide whether Emerson would have been liable for Section 16(b) profits had it held the Dodge shares until the merger was consummated, since it did not do so and the question is now moot.

Reduced to its essentials, what Emerson is saying is that it should be permitted to retain its short-swing profits resulting from the cash sale of the 37,000 shares of stock, because otherwise it would have been required to account to Reliance for the short-swing paper profits it would have realized upon the consummation of the merger. Yet the very purpose of Section 16(b) is to prevent the retention of such short-swing profits. Under any view of the case, Emerson is liable for Section 16(b) profits on its sale for cash of the 37,000 shares of Dodge stock.

Less obvious is the resolution of the further question: Should Emerson be held accountable for the profits realized on the September 13 sale of its remaining 115,282 shares even though at that time (by reason of its prior disposition of the 37,000 shares) Emerson was the beneficial owner of less than 10% of Dodge shares. We have concluded that under the peculiar facts of this case, Section 16(b) is applicable to the September 13 transaction.

We are convinced that while Emerson was the beneficial owner of 13.2% of Dodge shares, it determined to dispose of its entire stock holdings pursuant to a plan whereby it hoped to avoid, to the extent possible, Section 16(b) liability for short term profits. The guidelines of the plan were formulated in a letter written by its counsel to its board chairman under date of June 26, 1967. In that letter, counsel discussed alternatives to a proxy contest with Reliance, "principally *how* to dispose of, *at a profit,* the shares of Dodge stock which Emerson now owns." He took note of the "uncertainty" whether the very pur-

chase whereby Emerson became the holder of more than 10% of the Dodge stock should be taken into account for Section 16(b) purposes and advised that "Emerson should proceed on the assumption that 16(b) does apply and *should seek to avoid its consequences.*" It was counsel's opinion that if a merger occurred, Emerson would be considered to have "sold" its Dodge shares for Section 16(b) purposes. On that premise, he outlined "*defensive* action against 16(b) possibilities" which in his opinion should be taken by Emerson: "The *initial* defensive step * * * is for Emerson to reduce its holdings of Dodge stock to less than 10%. This means the gift or sale * * * of 37,100 shares of Dodge stock owned by Emerson. From this point on, Emerson, no longer being a 10% stockowner of Dodge can sell the balance of its Dodge stock free of any 16(b) risks; provided, of course, the second sale is not *legally tied* in any way to the first sale."

Because of the manner in which this case was submitted, the facts were not fully developed, as they might have been through vigorous cross-examination. However, the actions of Emerson when viewed in the light of its counsel's letter, clearly bespeak the fact that although the two sales of Dodge stock were technically separate transactions and the second sale was not "legally" tied in any way to the first sale, the two sales were effected pursuant to a single pre-determined plan of disposition with the overall intent and purpose of avoiding Section 16(b) liability. Emerson's initial sale of 37,000 shares[1] was motivated solely by its desire to reduce its holding to just under 10% immediately prior to disposing of the balance of its shares in an attempt to escape Section 16(b) liability on the short-swing profits it contemplated would be made upon such remaining shares. Significantly, the negotiations with Reliance commenced just one day after Emerson agreed by telephone conversation to sell the

[1] An increase in the number of Dodge outstanding shares made it necessary to sell only 37,000 instead of 37,100 shares as suggested in counsel's letter in order to reduce Emerson's holdings to less than 10%.

initial 37,000 shares to Goldman, Sachs & Company, and the agreement for the sale was tentatively arrived at one week thereafter subject only to the formalizing of the understanding. The timing was not a happenstance. That the negotiations with Reliance for the sale of the Emerson-held Dodge shares were initiated by Reliance does not affect our conclusion that the two sales were in fact interrelated parts of a single plan. In fact, in his June 26 letter, Emerson's counsel had anticipated the possibility of a settlement under a negotiated agreement providing for the purchase of the Dodge shares owned by Emerson, the settlement to provide for a sale by Emerson of at least 37,100 of its Dodge shares before the merger was approved by the stockholders.

Looking through form to discern substance, we hold that in truth and in fact the two sale transactions were related parts of a single plan devised by Emerson to dispose of all its Dodge stock in an attempt to "avoid the consequences" of Section 16(b). Emerson may not thus insulate from Section 16(b) liability the short-term profits derived from its disposition of the Dodge stock. To sanction this two-step sale procedure would be to subvert the purposes of Section 16(b) and to produce a result plainly at variance with its manifest policy. Unless appearances are to control, rather than reality, we believe that for purposes of this case the "time of sale" should include the entire period during which a series of related transactions take place pursuant to a plan by which a 10% beneficial owner disposes of his stock holdings.

We do not question the good faith of Emerson or its counsel. What we do question is its right to excise 16(b) liability or "avoid its consequences" by utilizing a series of related transactions, some of which considered separately might be exempt, when the obvious substance of the transaction as to a whole is the disposition of its more than 10% beneficial interest.

We hold that Emerson is liable to Reliance, as the successor in interest to Dodge, for the net profits realized by Emerson from the sale of all its 152,282 shares of Dodge

stock. Counsel for Reliance are directed to submit a form of interlocutory declaratory judgment in accordance herewith.

The foregoing memorandum constitutes our findings of fact and conclusions of law on the issue of liability.

Dated this 18th day of September, 1969.

/s/ JOHN K. REGAN,
United States District Judge.

No. 68 C 87 (3)

IN THE UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF MISSOURI,
EASTERN DIVISION.

EMERSON ELECTRIC CO.,
Plaintiff,
vs.
RELIANCE ELECTRIC COMPANY,
Defendant.

INTERLOCUTORY DECLARATORY JUDGMENT.

(Entered October 9, 1969.)

This cause came on to be heard by the Court on the pleadings, the evidence presented at trial, and the written stipulation and briefs of counsel for the parties, and the Court, being fully advised in the premises, finds the facts and law to be as set forth in its memorandum opinion dated September 18, 1969 and, accordingly, it is

ORDERED, ADJUDGED AND DECREED:

1. That plaintiff Emerson Electric Co. is liable to defendant Reliance Electric Company for the net profits real-

ized by plaintiff from the sales of 152,282 shares of stock of Dodge Manufacturing Company on August 28 and September 13, 1967.

The Court is of the opinion and therefore finds that this order involves controlling questions of law as to which there is substantial ground for difference of opinion and that an immediate appeal from this order under Title 28 U.S.C.A. § 1292(b) may materially advance the ultimate termination of this litigation.

IT IS HEREBY FURTHER ORDERED that this matter be certified under Title 28 U.S.C.A. § 1292(b) and that all proceedings in this cause be stayed pending the final action of the United States Court of Appeals for the Eighth Circuit.

Dated this 9th day of October, 1969.

/s/ JOHN K. REGAN,
United States District Judge.

No. Misc. 632.

IN THE UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT.

EMERSON ELECTRIC CO.,
a corporation,
Plaintiff-Petitioner,
v.
RELIANCE ELECTRIC COMPANY,
a corporation,
Defendant.

PETITION FOR PERMISSION TO TAKE AN APPEAL FROM AN INTERLOCUTORY ORDER PURSUANT TO 28 U. S. C. SECTION 1292(b) AND RULE 5 OF THE FEDERAL RULES OF APPELLATE PROCEDURE.

* * * * *

I. *Statement of Facts*

This action was originally brought in the district court by Emerson as a declaratory judgment action, seeking a determination of its liability, if any, to Reliance for any profits Emerson may have realized as a result of its transactions in the stock of Dodge Manufacturing Corporation, an Indiana corporation ("Dodge"). The facts before the district court were mostly stipulated. Prior to June 16, 1967, Emerson owned no shares of stock of Dodge and had no relationship whatsoever to Dodge. On or about May 22, 1967, Emerson made an offer to purchase up to 550,000 shares of the common stock of Dodge, pursuant to an offer for tenders made to Dodge stockholders. Dodge made an unsuccessful attempt to enjoin the Emerson tender offer in Indiana federal court. On June 16, 1967, Emerson elected to purchase all of the shares tendered by the Dodge stockholders, and accordingly did at that time

purchase 152,282 shares of Dodge common stock at $63.00 per share. The shares so purchased represented 13.2% of the outstanding Dodge common stock.

At about the time of Emerson's acquisition of the Dodge stock, Dodge and Reliance, an Ohio corporation, entered into an agreement in principle to merge Dodge into Reliance. Emerson made a counter-proposal, the effect of which would be to merge Dodge into Emerson. On August 22, 1967, a meeting of the Dodge stockholders was called, at which the plan of merger with Reliance was adopted and the Emerson proposal was rejected.

Thereupon, with the Dodge-Reliance merger upcoming, Emerson concluded that, rather than remain a stockholder of Dodge and accept the securities of Reliance pursuant to the Dodge-Reliance merger, it would undertake to dispose of its 152,282 shares of Dodge stock in two separate and distinct transactions—first a sale of 37,000 shares, reducing its holdings to less than 10%, and second a sale of the balance.

Accordingly, on August 28, 1967, Emerson sold 37,000 shares of its Dodge stock to Goldman Sachs & Co., a New York investment banking firm, for $68.00 per share. This reduced Emerson's holdings in Dodge stock to less than 10%.

On September 13, 1967, Emerson sold the remaining 115,282 shares of Dodge stock to Dodge for $69.00 per share. On September 29, 1967, the Dodge-Reliance merger was consummated, with Reliance the surviving corporation.

The two sales were negotiated separately, at different times, by different representatives of Emerson, for different prices, to different purchasers having no connection or relationship with each other and, except for the fact that they were made pursuant to Emerson's decision to dispose of its entire holdings of Dodge stock upon the most favorable terms, were separate and distinct from each other in every respect.

* * * * *

No. 20014.

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT.

September Term, 1969

EMERSON ELECTRIC CO.,

Appellant,

vs.

RELIANCE ELECTRIC COMPANY,

Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MISSOURI.

ORDER.

(November 6, 1969.)

The Court has considered petition for leave to take interlocutory appeal and answer in opposition thereto. Being fully advised in the premises, it is now here ordered that the petition for leave to take interlocutory appeal be, and it is hereby, granted.

The Clerk is directed to regularly docket this appeal.

No. 20,014.

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT.

EMERSON ELECTRIC CO.,

Appellant,

vs.

RELIANCE ELECTRIC COMPANY,

Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF MISSOURI, EASTERN DIVISION.

OPINION.

(November 12, 1970.)

Before GIBSON and LAY, Circuit Judges and HUNTER, District Judge.

HUNTER, District Judge.

This is an interlocutory appeal from a declaratory judgment holding that Emerson Electric Company is liable to Reliance Electric Company under Section 16(b) of the Security Exchange Act of 1934[1] for the net profits realized by Emerson from the sale on August 28, 1967, of 37,000 shares of the stock of Dodge Manufacturing Corporation and from the sale on September 13, 1967, of 115,282 shares of Dodge stock.[2] Only the issue concerning the amount of profits recoverable by Reliance has been reserved for future determination by the District Court.

---

[1] 48 Stat. 896 (1934); 15 U.S.C. § 78(P).

[2] The District Court certified the case for interlocutory appeal under authority of 28 U.S.C. § 1292(b) with leave granted by this Court to take the interlocutory appeal.

The salient facts are relatively undisputed.[3] Toward the end of 1966, Emerson, a St. Louis based manufacturer of electric motors, became interested in Dodge of Mishawaka, Indiana, a company engaged in the manufacture of transmission equipment and other devices used with electric motors. Dodge was a publicly held corporation, and its stock was listed on the New York Stock Exchange. Emerson engaged in merger negotiations with Dodge. On March 12, 1967, Emerson was advised that Dodge's board had rejected Emerson's merger offer. On March 22, 1967, Emerson withdrew its merger proposal, terminated negotiations with Dodge, and so advised the financial community.

On May 22, 1967, Emerson invited tenders of up to 550,000 shares of Dodge's common stock at a price of $63 per share, the tender offer to expire June 16, 1967. At that time Emerson elected to purchase all of the 152,282 tendered shares. These shares constituted 13.2 percent of the outstanding Dodge stock. Prior to June 16, 1967, Emerson had not owned any shares of Dodge stock.

Shortly before the Dodge stock acquisition by Emerson, Dodge and Reliance Electric & Engineering Company (now Reliance Electric Company) had entered into an agreement whereby Dodge was to be merged into Reliance.[4] Emerson sought to prevent the merger, which needed stockholder approval, advocating instead a merger with Emerson.[5]

---

[3] The parties stipulated to most of the essential facts prior to the trial, and the District Court has set them out in its opinion reported at 306 F.Supp. 588.

[4] The evidence indicates Dodge's management unexpectedly announced its intent to merge with Reliance.

[5] On May 27, 1967, Dodge filed suit in federal court in South Bend to enjoin Emerson from accepting any tenders and from further pursuing its tender offer. The District Court denied the injunction, finding in its memorandum opinion that Emerson did not have any "insider" information about Dodge and that all its knowledge about Dodge had been obtained from publicly available sources.

A stockholders' meeting to consider the merger proposal was called for August 22, 1967. A proxy fight ensued, the result of which was a victory for Reliance.[6] Shortly thereafter, but prior to the final approval of the Dodge-Reliance merger by the Dodge directors, Emerson sold its Dodge holdings. Emerson first sold 37,000 shares at $68 a share on August 28, 1967, to Goldman, Sachs & Company, investment brokers. This sale reduced Emerson's holdings to 9.96 percent of the then outstanding shares of Dodge. Then, on September 11, 1967, it sold the remaining 115,282 shares at $69 a share to Dodge.

The background of the two sales is that Emerson had been advised by its counsel by letter that Section 16(b) might apply if Emerson owned 10 percent or more of Reliance's stock at the time of a Reliance and Dodge merger; counsel further advised that Emerson reduce its holdings below 10 percent, and they advised that from that point on, Emerson, no longer being a 10 percent stockholder of Dodge, could sell the balance of its Dodge stock free of any 16(b) risk, "provided, of course, the second sale is not legally tied in any way to the first sale." [7]

---

[6] Emerson made a counter-proposal in opposition to Reliance's merger offer and the Dodge board opposed it and refused to allow Emerson to examine the list of Dodge's shareholders. Emerson successfully filed suit to obtain the list.

[7] See, Lang & Katz, Liability for "Short Swing" Trading in Corporate Reorganizations, 20 Sw. L.J. 472, 486-87 (1966); Roger George, The Application of Section 16(b) to Mergers: A Hidden Hazard, 47 Tex. L. Rev. 1417 (1969).

The letter written ten days after Emerson had purchased its Dodge shares advised that in view of the uncertainty as to whether Emerson's purchases would be subject to Section 16(b) Emerson should seek to avoid 16(b) consequences by reducing its holdings to less than 10 percent by means of gift or sale prior to August 22, 1967, of 37,150 shares of Dodge stock; "[that] from this point on, Emerson, no longer being a 10 percent stock owner of Dodge, can sell the balance of its Dodge stock free of any 16(b) risk; provided, of course, the second sale is not legally tied in any way to the first sale." * * * "It may be possible at some-

(*Continued on following page*)

Emerson sold the mentioned 37,000 shares, reducing its holding to 9.9 percent of Dodge stock. On August 29, 1967, counsel for Reliance initiated discussions with counsel for Emerson to purchase the remaining 115,282 shares of common stock of Dodge from Emerson. Prior to this time Emerson had not offered to sell the 115,282 shares of Dodge to Reliance.

Based essentially on these facts, the District Court found that Emerson's two sales transactions were related parts of a single plan devised by Emerson to dispose of all of its Dodge stock in an attempt to avoid the consequences of Section 16(b), and held Reliance was entitled to the profits from both sales.[8] This appeal followed.

(*Continued from preceding page*)

time before the Dodge-Reliance merger vote to agree upon a settlement with these companies under a negotiated agreement providing for the purchase of the Dodge shares owned by Emerson and/or the Reliance preferred shares to be received if the Dodge-Reliance merger is effected. It seems necessary however, that any such settlement provide for a sale by Emerson of at least 37,100 of its Dodge shares before the August 22, meeting date."

[8] For the full reasoning of the District Court, see 306 F.Supp. 588, 591-593 (E.D. Mo. 1969), wherein it is stated, loc. cit. 592: ". . . although the two sales of Dodge stock were technically separate transactions and the second sale was not "legally" tied in any way to the first sale, the two sales were effected pursuant to a single pre-determined plan of disposition with the overall intent and purpose of avoiding Section 16(b) liability. Emerson's initial sale of 37,000 shares was motivated solely by its desire to reduce its holdings to just under 10% immediately prior to disposing of the balance of its shares in an attempt to escape Section 16(b) liability on the short-swing profits it contemplated would be made upon such remaining shares."

* * *

"Looking through form to discern substance, we hold that in truth and in fact the two sale transactions were related parts of a single plan devised by Emerson to dispose of all its Dodge stock in an attempt to 'avoid the consequences' of Section 16(b). . . . [W]e believe that for purposes of this case the 'time of sale' should include the entire period during which a series of related transactions take place pursuant to a plan by which a 10% beneficial owner disposes of his stock holdings."

Section 16(b) of the Securities Exchange Act

Section 16(b) reads:

> "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer, in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. * * * *This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved,* or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection." (Italics added.)

Thus, under the provisions of Section 16(b) owners owning more than 10 percent or more of the security of a company "*both at the time of the purchase and sale,* or the sale and purchase of the security involved" are accountable to the corporation for any profit realized on the security transactions made within a six month period.[9]

The initial question presented on this appeal is whether Emerson's purchase of 13.2 percent of the outstanding shares of Dodge's common stock, when prior to such purchase Emerson had not owned any Dodge securities, made

---

[9] Section 16(a) reads: "Every person who is directly or indirectly the beneficial owner of *more than 10 per centum* of any class of any equity security (other than an exempted security) which is registered on a national securities exchange." (Italics added.)

Emerson at the time of that very purchase a more than 10 percentum beneficial owner within the meaning of Section 16(b).

It is Emerson's position that the exemption provision of Section 16(b) applicable to more than 10 percent beneficial owners specifically exempts any transaction where such beneficial owner was not such *both at the time of purchase and sale*, and that "at the time of" means "prior to" the purchase in question. However, Reliance contends that "at the time of" means "simultaneously with" the purchase in question. Both parties cite an array of text and Law Review commentaries which reflect there exists no unanimity on the part of legal scholars on the question presented.[10]

There is reasonable unanimity as to the *broad* purpose sought to be served by the enactment of Section 16(b). In one of the Congressional Committee Reports on the pending legislative act concerning the subject of the evils of certain "short-swing trading" it was declared that a purpose of 16(b) was "to protect the interests of the public against the predatory operations of directors, officers, and principal stockholders of corporations by preventing them from speculating in the stock of the corporations

---

[10] For some examples, see: W. Painter, Federal Regulation of Insider Trading, Chpt. III, pp. 24-52 (1968); Note, Short-Swing Profits and the Ten Percent Rule, 9 Stan. L. Rev. 582 (1957); Note, Stockholder Acquiring 10% Ownership on Purchase Held Liable for Profits Under Section 16(b) of the Securities Exchange Act, 57 Colum. L. Rev. 287 (1957); Note, Director Held Liable Under Section 16(b) for Short Swing Profits on Stock Purchased Prior to His Becoming a Director, 45 Va. L. Rev. 1057 (1959); Note, Purchase of Stock By Which Stockholder Becomes a 10% Beneficial Owner is Covered by § 16(b), 70 Harv. L. Rev. 1312 (1957); Seligman, Problems Under the Securities Exchange Act, 21 Va. L. Rev. 1 (1934); Lowenfels, Section 16(b): A New Trend In Regulating Insider Trading, 54 Corn. L. Q. 45 (1968); Munter, Section 16(b) of The Securities Exchange Act of 1934; An Alternative to "Burning Down The Barn In Order to Kill the Rats," 52 Corn. L. Q. 69 (1966); Note, Insider Trading: The Issuer's Disposition of An Alleged 16(b) Violation, 1968 Duke L. Rev. 94; George, The Application of Section 16(b) To Mergers: A Hidden Hazard, 47 Texas L. Rev. 1417 (1969).

to which they owed a fiduciary duty." [11] While not unanimous, the majority of the text and law review writers, as well as the majority of the case decisions, appear to concede that the 16(b) statutory language "both at the time of purchase and sale" is not clear and has an element of ambiguity. As one writer expressed it, "at the time" is not a phrase of precise meaning. It may refer to a condition existing either "immediately before", "simultaneously with" or "immediately after" a given event. It is doubtful that Congress intended it to have one of those meanings in every situation. Therefore, without departing from the statute the words "at the time" might mean "immediately before" in the case of a purchase and "simultaneously with" in the case of a repurchase.[12]

Prior Decisions

In spite of the intense interest in the question, there is a paucity of judicial decision on the precise question presented on this appeal. It was the case of *Stella v. Graham-Paige Motors Corp.*, 232 F.2d 299 (2nd Cir. 1956), cert. den. 352 U.S. 831 (1956) affirming 104 F. Supp. 957 (S.D. N.Y. 1952) that provided the notable decision in the still continuing battle concerning proper interpretation of the Section 16(b) words "at the time of". The Second Circuit, in a two-to-one opinion rejected the defendant's contention that the proviso required the exclusion of a person who was not a 10 percent owner before each of the transactions involved. Instead, the Court based its decision on the interpretation of the proviso adopted by the district court and supported by the SEC in an amicus brief, that a 10 percent stockholder need only be such simultaneously with each transaction; that is, just after a purchase or just before a sale.[13]

---

[11] S. Rep. No. 1455, 73d Cong., 2d Sess. 68 (1934). See also: 48 Stat. 881 (1934); 15 U.S.C. § 78.

[12] Note, Stockholder Acquiring 10% Ownership on Purchase Held Liable for Profits Under Section 16(b) of the Securities Exchange Act, 57 Colum. L. Rev. 287, 289 (1957).

[13] To the contrary, see, *Arkansas Louisiana Gas Co. v. W. R. Stephens Investment Co.*, 141 F.Supp. 841 (W.D. Ark. 1956).

Courts having the occasion to interpret the Securities Act with regard to questions other than the precise one we have before us have generally held that the Act should be liberally construed to carry out the express legislative policy.[14]

While the problem of interpretation is difficult and not free of all doubt, we are persuaded that in the case before us the District Court reached the right result in its holding that the purchase by which one becomes a more than 10 percentum stockholder, where followed by a sale within six months of some or all of the purchased security makes the purchaser a more than 10 percentum beneficial owner within the meaning of Section 16(b) "both at the time of the purchase and sale." We endeavor to give our reasons for reaching this result.

We are persuaded that the Congressional intent, albeit broad and not as clear as desirable, was to authorize recovery of any realized profit by directors, officers and certain large stockholders who engaged in short-swing transactions (six months or less) of sale and purchase or purchase and sale. The intent as to such short-swing transactions was to stop the *possible*, not the actual—for that was considered to be too difficult to prove—use of inside information.[15] It is clear that Section 16(b) applies

---

[14] See *Cresswell-Keith, Inc. v. Willingham*, 264 F.2d 76, 80 (8th Cir. 1959). See, *Western Auto Supply Co. v. Gamble-Skogmo, Inc.*, 348 F.2d 736, 743 (8th Cir. 1965), where we stated, "The Supreme Court in *Blau v. Lehman*, 368 U.S. 403, 414, 82 S.Ct. 451, 7 L.Ed.2d 403 (1962), speaks of the 'prophylactic' effect Congress clearly prescribed in § 16(b). Other cases cited in this opinion refer to § 16(b) as being 'remedial', 'broadly remedial', 'thorough-going', and 'absolute' in strictly construing the statute against the insider in order to effectuate its wholesome purpose."

[15] Actual culpability is not required of the narrow class of persons to which Section 16(b) applies. As said by Judge Learned Hand in *Gratz v. Claughton*, 187 F.2d 46, 49-50 (2nd Cir. 1951), cert. den. 341 U.S. 920 (1951): "The section does indeed cover trading by those who in fact have no such information, ... If only those persons were liable, who could be proved to have a bargaining advantage, the execution of the statute would be so encumbered as to defeat its whole purpose." See,

(*Continued on following page*)

to every more than 10 percentum beneficial owner without regard to his factual access to or possession of inside information. The statute speaks only of more than 10 percentum beneficial owners and not of "insiders". It does not require inside knowledge or bad motive. It is also sufficiently clear that Congress intended that Section 16(b) apply to only those or only to that class recognized by the 16(b) statutory language as generally having the opportunity of obtaining inside information, and that more than 10 percent security holders were deemed by Congress to be of that class.[16]

Thus, to carry out the general purpose Congress sought by enactment of the statute, having in mind that at least to some degree that language is not free of ambiguity, we have concluded that the purchase by which a security holder acquires a more than 10 percentum status is included as a part of a pair of transactions of purchase and sale occurring within six months of each other within the meaning of Section 16(b). Any other view has the weakness of impracticability of application of the statute, a result we should not lightly attribute to a Congress striving to prevent what it considered to be highly undesirable speculations by certain security owners who are

---

(*Continued from preceding page*)

also, *Western Auto Supply Co. v. Gamble-Skogmo, Inc., supra* at 743, "We cannot have one rule for insiders with good intentions and another for those who would flagrantly abuse their trust. The burden of the Act must fall on all violations with equal weight." Thus, Section 16(b) is viewed as not penal requiring intent to misuse inside information but simply remedial to remove the right to retain profits obtained while in the advantageous position the statute describes.

[16] "The corporation is thus provided with a method of recoupment from insiders profits realized either through purchases of an equity security followed by its sale at a higher price, or from sale of an equity followed by a purchase at a lower price within the six month period. Once the statutory conditions have been fulfilled, it is irrelevant that the insider either did not make unfair use of inside information or that he might not have intended, at the time he purchased the security, to sell it within six months." Painter, Federal Regulations of Inside Trading, Chpt. III, pp. 24-25 (1968).

in position to obtain or to be exposed to that kind of inside information lending itself to speculative use to the possible detriment of the public.

Illustrative of some of the mischief that would be permitted in spite of Congress' action in enacting 16(b) if we accorded with Emerson's contentions is an initial purchase of as large a block of stock as 51 percent or more of a corporation's stock, followed by a sale any time within six months by the stockholder who obviously within that period could obtain much inside information and also could influence, manipulate or control corporate transactions. The deterrence of such apparent potential mischief must have been within the contemplation of Congress.[17]

Nor does the fact that Emerson acquired its stock in an effort to merge with Dodge and sold it after such merger appeared no longer possible exempt Emerson from the ambit of Section 16(b). An insider engaged in a contest for control of its stock issuer may have substantial opportunity for short-term profits perforce of its substantial stock ownership. In less than three months from its stock purchase Emerson apparently had made substantial short term profits related to its stock acquisition activities in its effort to gain stock control of Dodge.[18]

We reach the last question of the present appeal; namely, whether Emerson's sale of 115,282 shares of stock on September 13, 1967, within six months of its

---

[17] One notorious example before Congress concerned brothers who within a short time before company passed a dividend sold their stock for $16,000,000 and after the dividend became public repurchased an equivalent amount for $7,000,000. See: S. Rep. No. 792, 73rd Cong., 2nd Sess. 9 (1934).

[18] See: Note, Insider Trading: The Issuer's Disposition of an alleged 16(b) Violation, 1968 Duke L.J. 94, 97. "Section 16(b) often imposes liability on the 'innocent' insider who has not abused his position since the unfair use of confidential information by insiders or the intent to profit by its use is irrelevant to the question of liability under section 16(b)." *Petteys v. Butler*, 367 F.2d 528 (8th Cir. 1966), cert. den. 384 U.S. 1006 (1967); *Smolowe v. Delendo Corp.*, 136 F.2d 231 (2 Cir. 1943), cert. den. 320 U.S. 751 (1943).

acquisition of 13.2 percent of Dodge's stock, but at a time when Emerson had reduced its stock holdings to below 10 percent of Dodge's stock, is a transaction where the beneficial owner was a more than 10 percent beneficial owner both at the time of the purchase and sale within the intendment of Section 16(b). The District Court found that while Emerson was the beneficial owner of 13.2 percent of Dodge shares it determined to dispose of its entire stock holdings pursuant to a plan whereby it hoped to avoid, to the extent possible, Section 16(b) liability for short term profits. Pursuant to that determination it made the mentioned two separate sales not tied in any legal way to each other.

Insofar as we are advised the question presented by the second sale is one of first impression. Our review of the record indicates the District Court's finding as a fact that Emerson made two separate sales not legally tied together in any way, with the described intent to avoid losing its profit on its second sale because of possible Section 16(b) applicability, is not clearly erroneous, and is supported by substantial evidence. The factual question as to whether a particular sale is a separate and independent sale is a matter for decision under the peculiar facts of the particular case. In this regard each case must stand or fall on its own facts.

However, there is no reason why a person may not conduct his business in such a way as to intentionally minimize or eliminate his loss of profits under Section 16(b) by any means permitted by law. Such conduct is to some extent analogous to tax avoidance conduct which is permissible.[19] We, therefore, do not fault Emerson for its

---

[19] See *Helvering v. Gregory*, 69 F.2d 809, 810 (2nd Cir. 1934): ". . . A transaction, otherwise within the exception of the tax law, does not lose its immunity, because it is actuated by a desire to avoid, or, if one choose, to evade, taxation. One may so arrange his affairs that his taxes shall be as low as possible . . . ." On appeal, the Supreme Court affirmed saying: "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted." *Gregory v. Helvering*, 293 U.S. 465, 469 (1934).

effort to avoid the total loss of profits on its 152,282 shares of stock by first reducing its holdings by means of a bona fide sale to below 10 percent, and then in a later, independent bona fide sale while owning less than 10 percent, dispose of its remaining shares.

Concededly, Congress through Section 16(b) did not endeavor to deny profits resulting from all insider transactions. Stock held one day more than six months before being sold escaped Section 16(b) regulation entirely. Stock amounting to a bare fraction less than the "more than 10 percentum" likewise escaped Section 16(b) entirely. The standards set forth in Sections 16(a) and 16(b) are arbitrary both in the selection of time, 6 months, and the selection of amount, more than 10 percentum. A security transaction either falls within or without the scope of Section 16(b) depending on whether these arbitrary standards are met.[20] A security holder such as Emerson does suffer some detriment albeit small in its two short-swing transactions in that it does lose its profit acquired from its first sale, made while it was a more than 10 percentum security holder. After that sale the arbitrary standards enacted by Congress in 16(b) of a "more than 10 percentum" security holder are no longer met, and subsequent sales appear to be free of Section 16(b) regulation. Such subsequent sales literally fall within the exemption language of 16(b): "[T]his subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale . . . ."

Since we have determined as a matter of law that intent as such to avoid loss of realized profits by engaging in two independent sales not legally tied to each other and

---

[20] Some scholars note a recent trend to be more realistic and less formalistic in applying 16(b), especially in defining what is a sale, a purchase, and a transaction within the ambit of the Act. See, Lowenfels, Section 16(b): A New Trend In Regulating Insider Trading, 54 Corn. L. Rev. 45 (1968); *Petteys v. Butler*, 367 F.2d 528 (8th Cir. 1966), cert. den. 385 U.S. 1006 (1969); *Blau v. Lamb*, 363 F.2d 507 (2nd Cir. 1966), cert. den. 385 U.S. 1002 (1967).

made at different times to different buyers such as these described above, does not result in treating the two sales as one sale of the entire stock held, nor as one continuous transaction; we look to 16(b) to determine whether the second sale was a sale otherwise proscribed by that section. While we agree that Section 16(b) is to be broadly and liberally construed to achieve the intent of Congress, we are unable to discern from any of the Congressional hearings or from the broad basic purpose of 16(b) any intent on the part of Congress not to mean what it has literally said in the 16(b) exclusion clause, giving the words used in that clause a liberal and reasonably flexible meaning. We are not free under the guise of statutory interpretation to rewrite statutes so as to include matters which for unexpressed reasons Congress did not include.[21] We believe it clear that this second and independent sale of September 13 was not made at the time Emerson was a more than 10 percentum stockholder, whether the phrase "at the time of" be viewed as meaning immediately before, simultaneously with or immediately after the 10 percentum stockholder status. Hence, Emerson is not required to pay over to Reliance any profits realized from that sale.

Accordingly, we remand this cause to the District Court with directions to proceed in accordance with the views expressed herein.

IT IS SO ORDERED.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit.

---

[21] It is noteworthy the preamble was in none of the bills on which public hearings were held. The bill submitted to the House by the Committee on Interstate and Foreign Commerce completely omitted the future 16(b). The bill submitted by the Banking and Currency Committee to the Senate was the first to contain the preamble. See, S. Rep. 3420, 73rd Congress, 2nd Sess., 16(b) 1934; Note, Short-Swing Profits and the Ten Percent Rule, 9 Stan. L. Rev. 582, 586, N. 23 (1957).

No. 20014.

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT.

September Term, 1970.

EMERSON ELECTRIC CO.,

Appellant,

vs.

RELIANCE ELECTRIC COMPANY,

Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MISSOURI.

ORDER.

(November 12, 1970.)

Appeal from the United States District Court for the Eastern District of Missouri.

This Cause came on to be heard on the record from the United States District Court for the Eastern District of Missouri and was argued by counsel.

On Consideration Whereof, it is now here ordered and adjudged by this Court that this Cause be and it is hereby remanded to the said District Court with directions to proceed in accordance with the views expressed in the opinion of this Court this day filed herein.

LIBRARY
SUPREME COURT, U.S.

Supreme Court, U.S.
FILED
FEB 9 1971
E. ROBERT SEAVER, CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1970.

No. ~~1382~~ 70-79

RELIANCE ELECTRIC COMPANY,
Petitioner,

v.

EMERSON ELECTRIC COMPANY,
Respondent.

PETITION FOR A WRIT OF CERTIORARI
To the United States Court of Appeals
For the Eighth Circuit.

ROBERT J. HOERNER,
THOMAS P. MULLIGAN,
PATRICK J. AMER,
1750 Union Commerce Building,
Cleveland, Ohio 44115,
KENNETH S. TEASDALE,
Railway Exchange Building,
611 Olive Street,
St. Louis, Missouri 63101,
Counsel for Petitioner.

Of Counsel:
JONES, DAY, COCKLEY & REAVIS,
ARMSTRONG, TEASDALE, KRAMER & VAUGHAN.

THE GATES LEGAL PUBLISHING CO., CLEVELAND, OHIO—TEL. (216) 621-5647

INDEX.

Opinions below 1

Jurisdiction 2

Question presented 2

Statute involved 3

Statement of the case 4

Reasons for granting the writ 6

Appendix A. Opinion of the Court of Appeals 12

Appendix B. Judgment of the Court of Appeals 27

Appendix C. Opinion of the District Court 28

Appendix D. Judgment of the District Court 38

CITATIONS.

Cases.

Abrams v. Occidental Petroleum Corp., CCH Fed. Sec. L. Rep. ¶ 92,875 (S.D.N.Y. November 27, 1970) 7

Bershad v. McDonough, 428 F.2d 693 (7th Cir. 1970), *cert. denied*, No. 791, October 1970 Term, 39 U.S.L. Week 2397 (1971) 9, 10

Blau v. Lamb, 363 F.2d 507 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967) 8-9

Smolowe v. Delendo Corp., 136 F.2d 231 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943) 8

Statutes.

Securities Exchange Act of 1934, Section 16(b), 15 U.S.C. § 78p(b) 2, 3, 6, 7, 8, 9, 10

Securities Exchange Act of 1934, Section 10(b) 8

Miscellaneous.

Wall Street Journal, January 27, 1969 6

In the Supreme Court of the United States

OCTOBER TERM, 1970.

No. _____.

RELIANCE ELECTRIC COMPANY,

Petitioner,

v.

EMERSON ELECTRIC COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI To the United States Court of Appeals For the Eighth Circuit.

Reliance Electric Company, the petitioner herein, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit entered in the above cause on November 12, 1970.

OPINIONS BELOW.

The opinion of the United States Court of Appeals for the Eighth Circuit, reported at CCH Fed. Sec. L. Rep. ¶ 92,863, and not yet reported in the Federal Reporter, is reprinted in Appendix A. The judgment of the Eighth Circuit, filed on November 12, 1970, is reprinted in Appendix B. The Memorandum Opinion of the United States District Court for the Eastern District of Missouri, filed on September 18, 1969, and reported at 306 F. Supp. 588, is reprinted in Appendix C. The Interlocutory Declaratory Judgment of the District Court, filed on October 9, 1969, is reprinted in Appendix D.

JURISDICTION.

The judgment of the United States Court of Appeals for the Eighth Circuit was entered on November 12, 1970. No rehearing was sought. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTION PRESENTED.

May the beneficial owner of more than 10% of an issuer's stock, desiring to sell all of its stock of the issuer at a profit within six months of the purchase of such stock, insulate from Section 16(b) of the Securities Exchange Act of 1934 and retain for its own benefit the short-term profits on 9.96% of such stock by effecting its single predetermined plan of disposition through the technique of two sales, the first of which reduces the beneficial owner's holdings to 9.96%, and the second of which disposes of the balance?

STATUTE INVOLVED.

The relevant portions of the text of Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), are as follows:

> Section 16(b). For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner [the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 12 of this title],[1] director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. . . . This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

---

[1] The bracketed words are taken from Section 16(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(a).

STATEMENT OF THE CASE.

On June 16, 1967, pursuant to a tender offer for shares of Dodge Manufacturing Company ("Dodge"), Emerson Electric Company ("Emerson") purchased 152,282 shares of Dodge stock at $63 per share. These shares constituted 13.2% of the then outstanding Dodge common stock. On August 28, 1967, Emerson sold 37,000 shares of Dodge stock on the New York Stock Exchange at $68 a share, reducing its holdings to 9.96% of the then outstanding Dodge common stock. On the following day, August 29, 1967, Emerson entered into negotiations with Dodge, and on September 13, 1967, Emerson sold the remaining 115,282 shares to Dodge at $69 per share. On September 29, 1967, Dodge merged into Reliance Electric Company ("Reliance"), petitioner herein.

On February 29, 1968, Emerson filed a petition for declaratory judgment in the United States District Court for the Eastern District of Missouri (the "District Court"), asking that the court determine and declare the liability, if any, of Emerson to Reliance for the amounts of the profits realized by Emerson from the two sales of Dodge stock described above. Jurisdiction of the District Court was based on Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. § 78aa), and upon diversity of citizenship and amount. In trial on the issue of liability alone, the District Court determined that Emerson is liable to Reliance for the net profits realized by it from the sales of all 152,282 shares of stock of Dodge, for the reasons set forth in its Memorandum Opinion filed September 18, 1969, Appendix C hereto.

The United States Court of Appeals for the Eighth Circuit (the "Eighth Circuit") granted Emerson's petition for leave to take interlocutory appeal under 28

U.S.C. § 1292(b). The Eighth Circuit accepted the findings of the District Court set forth below, but held that as a matter of law Section 16(b) does not apply to Emerson's profits on the second sale.

The relevant undisturbed findings of the District Court were (1) "Emerson's initial sale of 37,000 shares was motivated *solely* by its desire to reduce its holding to just under 10% immediately prior to disposing of the balance of its shares in an attempt to escape Section 16(b) liability on the short-swing profits it contemplated would be made on such remaining shares"; (2) ". . . that although the two sales of Dodge stock were technically separate transactions and the second sale was not 'legally' tied in any way to the first sale, the two sales were effected pursuant to a single pre-determined plan of disposition with the overall intent and purpose of avoiding Section 16(b) liability"; and (3) that ". . . the obvious substance of the transaction as to a whole is the disposition of its [Emerson's] more than 10% beneficial interest."[2]

---

[2] Emphasis added throughout.

REASONS FOR GRANTING THE WRIT.

Prior to the decision of the Eighth Circuit in the instant case, no federal court had ever approved a technique by which a statutory insider could so shape his transactions in his issuer's shares as to insulate from Section 16(b) a substantial portion of profits realized by him from stock purchases and sales within a six-month period. Now, for the first time in the history of decisions under Section 16(b), short-term profits may be made, and kept, by an insider who follows what the District Court called the "two-step sale procedure" used by Emerson and approved by the Eighth Circuit.

It can be expected that the two-step sale technique will become the "standard operating procedure" in every short-term disposition of stock by a 10% beneficial owner, to the detriment of the investing public which Section 16(b) was designed to protect, unless this Court agrees to review the decision below. For corporate insiders with informed counsel using this technique, the Eighth Circuit will have in effect amended Section 16(b) so as to strike the words "any profit" and insert the words "that portion of profits which exceeds the profits realized on sale of 9.9% of the issuer's stock."

The recent increase in corporate takeover bids by tender offer has greatly magnified the opportunities for 10% beneficial owners to take short-term profits. Indeed, it is widely understood in the national financial community that a company which makes a takeover bid by tender offer can usually make short-term profits on the stock so acquired if its merger proposal is rejected. As the Wall Street Journal reported (January 27, 1969, at 1, col. 6):

> A company can hardly lose by making a merger proposal these days. If its proposal is accepted, it

gets an acquisition. If its proposal is spurned, it usually makes money in the stock market.

For a company proposing a merger nowadays usually will first buy some stock in its intended partner. Announcement of its proposal usually pushes up the price of that stock—and the price tends to stay up even if the merger falls through, allowing the rejected company to sell out at a profit. The profit can be particularly big if, as often happens, the rejected company loses out to another concern that makes a better offer; the price of stock in a company wooed by several would-be merger partners usually rises with each successive bid.

This sequence has occurred often enough to produce some of the happiest rejected suitors ever seen.

Until recently, Section 16(b) has protected the investing public against the more flagrant cases of short-term profit-taking arising out of tender offers. Now the Eighth Circuit has removed this protection and has created a loophole through which very substantial short-swing profits will in the future be made. Thus, for example, in the very recent decision of *Abrams v. Occidental Petroleum Corp.*, CCH Fed. Sec. L. Rep. ¶ 92,875 (S.D.N.Y. Nov. 27, 1970), Occidental Petroleum was held liable under Section 16(b) for about $17,700,000 of short-term profits in the purchase and sale of shares of Kern County Land Company. If Occidental had followed the technique used by Emerson, and had entered into two option agreements with different optionees on different days, pursuant to a plan, Occidental would have insulated from recovery, by means which the Eighth Circuit now permits, more than $8,600,000 of its short-term profits in Kern County Land Company stock.

The rule of the Eighth Circuit has wider application than simply to the tender offer situation. The two-step

sale procedure can be used by any 10% beneficial owner to make and keep short-term profits free from the reach of Section 16(b).[3] Thus, for example, if Jones, the owner of 15% of the stock of X Corporation, learns by virtue of his position as an insider that at a directors' meeting two weeks hence the quarterly dividend will be reduced, Jones can thereupon, pursuant to a plan, sell 5.1% of his stock, wait a week, and then sell the remaining 9.9%. After the directors have met and lowered the dividend, and the market has responded to the news, Jones can repurchase his 15%. Under the general rule set forth by the Eighth Circuit in the decision below, Jones will pay just over one-third of his short-term profits, the profit on the sale and repurchase of 5.1% of the stock, to X Corporation, and will pocket his short-term profits on the remaining 9.9%.

In the first case to arise in the federal courts construing Section 16(b), *Smolowe v. Delendo Corp.*, 136 F.2d 231, 239 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943), the Second Circuit Court of Appeals determined that:

> . . . [T]he statute was intended to be *thoroughgoing*, to squeeze *all possible profits* out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or stockholder and the faithful performance of his duty.

In 28 years of judicial construction of Section 16(b), the federal courts have uniformly applied this standard. As the Second Circuit Court of Appeals stated in *Blau v.*

---

[3] The fact that there may be a cause of action against an insider using the two-step sale procedure under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder does not provide an adequate substitute for a deficiency in Section 16(b), for the plaintiff in a Rule 10b-5 suit has the burden of showing actual abuse of inside information. Section 16(b), with its automatic "rule-of-thumb" operation, was enacted precisely to eliminate this often very difficult burden of proof.

Lamb, 363 F.2d 507, 516 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967):

> . . . [T]he theory of regulation underlying Section 16(b) requires the application of this section to every transaction that *might possibly permit* an insider to use inside information unfairly . . . .

A decision which permits an insider, in the words of the Eighth Circuit, to "intentionally minimize or eliminate his loss of profits under Section 16(b)" simply by his own careful arrangement of the *form* of his transactions, and thus to retain cash profits on sales of stock held less than three months, is clearly in conflict with the standards of fiduciary conduct heretofore applied by federal courts construing Section 16(b).

The recent decision of *Bershad v. McDonough*, 428 F.2d 693 (7th Cir. 1970), *cert. denied*, No. 791, October 1970 Term, 39 U.S.L. Week 2397 (1971), is the closest prior decision to the decision below. There the two-step sale procedure designed to avoid Section 16(b) liability consisted of an "option" agreement entered into within the six month period, and exercise of the option immediately after the six month period had passed. The Seventh Circuit, holding that what was an option agreement as a matter of contract law constituted a "sale" under Section 16(b), stated the applicable rule as follows (428 F.2d at 697):

> The phrase "any purchase and sale" in Section 16(b) is therefore *not* to be limited or defined solely in terms of commercial law of sales and notions of contractual rights and duties. . . . The insider should *not* be permitted to speculate with impunity merely by varying the paper form of his transactions.

In contrast, the Eighth Circuit in the instant case based its decision that Section 16(b) did not apply to Emerson's

second sale squarely upon the commercial and contractual characteristics of Emerson's transactions. The Eighth Circuit predicated its holding on the finding of the District Court that Emerson's two sales were "not legally tied together in any way," although this finding clearly meant only that the two sales were not tied together as a matter of contract law or commercial law (for the District Court did find the sales inseparably linked under federal securities law). The rule applied below is therefore in direct conflict with the rule applied in *Bershad v. McDonough*.

In the 36 years since its enactment, Section 16(b) has been a cordially disliked but impressively effective piece of legislation. A large part of the great success of Section 16(b) in elevating standards of insider conduct has been due to the well-founded belief of corporate insiders that no "technique" or method of framing their transactions will permit them to retain profits on sales of shares acquired within six months. The decision below establishes for the first time a significant exception to this rule, because it does approve a technique whereby an insider can readily take short-term insider profits at will. The effectiveness of Section 16(b) as a standard of conduct for corporate insiders will be materially impaired if this Court permits the technique for taking short-term profits approved by the Eighth Circuit Court of Appeals to stand unreviewed.

For the foregoing reasons, this petition for writ of certiorari should be granted.

Respectfully submitted,

ROBERT J. HOERNER,
THOMAS P. MULLIGAN,
PATRICK J. AMER,
1750 Union Commerce Building,
Cleveland, Ohio 44115,

KENNETH S. TEASDALE,
Railway Exchange Building,
611 Olive Street,
St. Louis, Missouri 63101,
Counsel for Petitioner.

Of Counsel:

JONES, DAY, COCKLEY & REAVIS,
ARMSTRONG, TEASDALE, KRAMER & VAUGHAN.

APPENDIX A.

Opinion of the Court of Appeals.

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

No: 20,014

EMERSON ELECTRIC CO., a Missouri Corporation,
Appellant,

vs.

RELIANCE ELECTRIC COMPANY, an Ohio Corporation,
Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF MISSOURI, EASTERN DIVISION.

[November 12, 1970.]

Before GIBSON and LAY, Circuit Judges and HUNTER, District Judge.

HUNTER, District Judge.

This is an interlocutory appeal from a declaratory judgment holding that Emerson Electric Company is liable to Reliance Electric Company under Section 16(b) of the Security Exchange Act of 1934[1] for the net profits realized by Emerson from the sale on August 28, 1967, of 37,000 shares of the stock of Dodge Manufacturing Corporation and from the sale on September 13, 1967, of 115,282 shares

---

[1] 48 Stat. 896 (1934); 15 U.S.C. § 78(P).

of Dodge stock.[2] Only the issue concerning the amount of profits recoverable by Reliance has been reserved for future determination by the District Court.

The salient facts are relatively undisputed.[3] Toward the end of 1966, Emerson, a St. Louis based manufacturer of electric motors, became interested in Dodge of Mishawaka, Indiana, a company engaged in the manufacture of transmission equipment and other devices used with electric motors. Dodge was a publicly held corporation, and its stock was listed on the New York Stock Exchange. Emerson engaged in merger negotiations with Dodge. On March 12, 1967, Emerson was advised that Dodge's board had rejected Emerson's merger offer. On March 22, 1967, Emerson withdrew its merger proposal, terminated negotiations with Dodge, and so advised the financial community.

On May 22, 1967, Emerson invited tenders of up to 550,000 shares of Dodge's common stock at a price of $63 per share, the tender offer to expire June 16, 1967. At that time Emerson elected to purchase all of the 152,282 tendered shares. These shares constituted 13.2 percent of the outstanding Dodge stock. Prior to June 16, 1967, Emerson had not owned any shares of Dodge stock.

Shortly before the Dodge stock acquisition by Emerson, Dodge and Reliance Electric & Engineering Company (now Reliance Electric Company) had entered into an agreement whereby Dodge was to be merged into Reliance.[4] Emerson sought to prevent the merger, which

---

[2] The District Court certified the case for interlocutory appeal under authority of 28 U.S.C. § 1292(b) with leave granted by this Court to take the interlocutory appeal.

[3] The parties stipulated to most of the essential facts prior to the trial, and the District Court has set them out in its opinion reported at 306 F.Supp. 588.

[4] The evidence indicates Dodge's management unexpectedly announced its intent to merge with Reliance.

needed stockholder approval, advocating instead a merger with Emerson.[5]

A stockholders' meeting to consider the merger proposal was called for August 22, 1967. A proxy fight ensued, the result of which was a victory for Reliance.[6] Shortly thereafter, but prior to the final approval of the Dodge-Reliance merger by the Dodge directors, Emerson sold its Dodge holdings. Emerson first sold 37,000 shares at $68 a share on August 28, 1967, to Goldman, Sachs & Company, investment brokers. This sale reduced Emerson's holdings to 9.96 percent of the then outstanding shares of Dodge. Then, on September 11, 1967, it sold the remaining 115,282 shares at $69 a share to Dodge.

The background of the two sales is that Emerson had been advised by its counsel by letter that Section 16(b) might apply if Emerson owned 10 percent or more of Reliance's stock at the time of a Reliance and Dodge merger; counsel further advised that Emerson reduce its holdings below 10 percent, and they advised that from that point on, Emerson, no longer being a 10 percent stockholder of Dodge, could sell the balance of its Dodge stock free of any 16(b) risk, "provided, of course, the second sale is not legally tied in any way to the first sale."[7]

---

[5] On May 27, 1967, Dodge filed suit in federal court in South Bend to enjoin Emerson from accepting any tenders and from further pursuing its tender offer. The District Court denied the injunction, finding in its memorandum opinion that Emerson did not have any "insider" information about Dodge and that all its knowledge about Dodge had been obtained from publicly available sources.

[6] Emerson made a counter-proposal in opposition to Reliance's merger offer and the Dodge board opposed it and refused to allow Emerson to examine the list of Dodge's shareholders. Emerson successfully filed suit to obtain the list.

[7] See, Lang & Katz, Liability for "Short Swing" Trading in Corporate Reorganizations, 20 Sw. L.J. 472, 486-87 (1966); Roger

(Continued on following page)

Emerson sold the mentioned 37,000 shares, reducing its holdings to 9.9 percent of Dodge stock. On August 29, 1967, counsel for Reliance initiated discussions with counsel for Emerson to purchase the remaining 115,282 shares of common stock of Dodge from Emerson. Prior to this time Emerson had not offered to sell the 115,282 shares of Dodge to Reliance.

Based essentially on these facts, the District Court found that Emerson's two sales transactions were related parts of a single plan devised by Emerson to dispose of all of its Dodge stock in an attempt to avoid the consequences of Section 16(b), and held Reliance was entitled to the profits from both sales.[8] This appeal followed.

(Continued from preceding page)

George, The Application of Section 16(b) to Mergers: A Hidden Hazard, 47 Tex. L. Rev. 1417 (1969).

The letter written ten days after Emerson had purchased its Dodge shares advised that in view of the uncertainty as to whether Emerson's purchases would be subject to Section 16(b) Emerson should seek to avoid 16(b) consequences by reducing its holdings to less than 10 percent by means of gift or sale prior to August 22, 1967, of 37,150 shares of Dodge stock; "[that] from this point on, Emerson, no longer being a 10 percent stock owner of Dodge, can sell the balance of its Dodge stock free of any 16(b) risk; provided, of course, the second sale is not legally tied in any way to the first sale." * * * "It may be possible at sometime before the Dodge-Reliance merger vote to agree upon a settlement with these companies under a negotiated agreement providing for the purchase of the Dodge shares owned by Emerson and/or the Reliance preferred shares to be received if the Dodge-Reliance merger is effected. It seems necessary however, that any such settlement provide for a sale by Emerson of at least 37,100 of its Dodge shares before the August 22, meeting date."

[8] For the full reasoning of the District Court, see 306 F.Supp. 588, 591-593 (E.D. Mo. 1969), wherein it is stated, loc. cit. 592: ". . . although the two sales of Dodge stock were technically separate transactions and the second sale was not "legally" tied in any way to the first sale, the two sales were effected pursuant to a single pre-determined plan of disposition with the overall intent and purpose of avoiding Section 16(b) liability. Emerson's initial sale of 37,000 shares was motivated solely by its desire to

(Continued on following page)

Section 16(b) of the Securities Exchange Act

Section 16(b) reads:

"For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer, in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. * * * *This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved,* or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection." (Italics added.)

Thus, under the provisions of Section 16(b) owners owning more than 10 percent or more of the security of

---

(Continued from preceding page)

reduce its holdings to just under 10% immediately prior to disposing of the balance of its shares in an attempt to escape Section 16(b) liability on the short-swing profits it contemplated would be made upon such remaining shares."

* * *

"Looking through form to discern substance, we hold that in truth and in fact the two sale transactions were related parts of a single plan devised by Emerson to dispose of all its Dodge stock in an attempt to 'avoid the consequences' of Section 16(b). . . . [W]e believe that for purposes of this case the 'time of sale' should include the entire period during which a series of related transactions take place pursuant to a plan by which a 10% beneficial owner disposes of his stock holdings."

a company "*both at the time of the purchase and sale,* or the sale and purchase of the security involved" are accountable to the corporation for any profit realized on the security transactions made within a six month period.[9]

The initial question presented on this appeal is whether Emerson's purchase of 13.2 percent of the outstanding shares of Dodge's common stock, when prior to such purchase Emerson had not owned any Dodge securities, made Emerson at the time of that very purchase a more than 10 percentum beneficial owner within the meaning of Section 16(b).

It is Emerson's position that the exemption provision of Section 16(b) applicable to more than 10 percent beneficial owners specifically exempts any transaction where such beneficial owner was not such *both at the time of purchase and sale,* and that "at the time of" means "prior to" the purchase in question. However, Reliance contends that "at the time of" means "simultaneously with" the purchase in question. Both parties cite an array of text and Law Review commentaries which reflect there exists no unanimity on the part of legal scholars on the question presented.[10]

---

[9] Section 16(a) reads: "Every person who is directly or indirectly the beneficial owner of *more than 10 per centum* of any class of any equity security (other than an exempted security) which is registered on a national securities exchange." (Italics added.)

[10] For some examples, see: W. Painter, Federal Regulation of Insider Trading, Chpt. III, pp. 24-52 (1968); Note, Short-Swing Profits and the Ten Percent Rule, 9 Stan. L. Rev. 582 (1957); Note, Stockholder Acquiring 10% Ownership on Purchase Held Liable for Profits Under Section 16(b) of the Securities Exchange Act, 57 Colum. L. Rev. 287 (1957); Note, Director Held Liable Under Section 16(b) for Short Swing Profits on Stock Purchased Prior to His Becoming a Director, 45 Va. L. Rev. 1057 (1959); Note, Purchase of Stock By Which Stockholder Becomes a 10% Beneficial Owner is Covered by § 16(b), 70 Harv.

(Continued on following page)

There is reasonable unanimity as to the *broad* purpose sought to be served by the enactment of Section 16(b). In one of the Congressional Committee Reports on the pending legislative act concerning the subject of the evils of certain "short-swing trading" it was declared that a purpose of 16(b) was "to protect the interests of the public against the predatory operations of directors, officers, and principal stockholders of corporations by preventing them from speculating in the stock of the corporations to which they owed a fiduciary duty." [11] While not unanimous, the majority of the text and law review writers, as well as the majority of the case decisions, appear to concede that the 16(b) statutory language "both at the time of purchase and sale" is not clear and has an element of ambiguity. As one writer expressed it, "at the time" is not a phrase of precise meaning. It may refer to a condition existing either "immediately before", "simultaneously with" or "immediately after" a given event. It is doubtful that Congress intended it to have one of those meanings in every situation. Therefore, without departing from the statute the words "at the time" might mean "immediately before" in the case of a purchase and "simultaneously with" in the case of a repurchase.[12]

(Continued from preceding page)

L. Rev. 1312 (1957); Seligman, Problems Under the Securities Exchange Act, 21 Va. L. Rev. 1 (1934); Lowenfels, Section 16(b): A New Trend In Regulating Insider Trading, 54 Corn. L. Q. 45 (1968); Munter, Section 16(b) of The Securities Exchange Act of 1934; An Alternative to "Burning Down The Barn In Order to Kill the Rats", 52 Corn. L. Q. 69 (1966); Note, Insider Trading: The Issuer's Disposition of An Alleged 16(b) Violation, 1968 Duke L. Rev. 94; George, The Application of Section 16(b) To Mergers: A Hidden Hazard, 47 Texas L. Rev. 1417 (1969).

[11] S. Rep. No. 1455, 73d Cong., 2d Sess. 68 (1934). See also: 48 Stat. 881 (1934); 15 U.S.C. § 78.

[12] Note, Stockholder Acquiring 10% Ownership on Purchase Held Liable for Profits Under Section 16(b) of the Securities Exchange Act, 57 Colum. L. Rev. 287, 289 (1957).

Prior Decisions

In spite of the intense interest in the question, there is a paucity of judicial decision on the precise question presented on this appeal. It was the case of *Stella v. Graham-Paige Motors Corp.*, 232 F.2d 299 (2nd Cir. 1956), cert. den. 352 U.S. 831 (1956) affirming 104 F. Supp. 957 (S.D. N.Y. 1952) that provided the notable decision in the still continuing battle concerning proper interpretation of the Section 16(b) words "at the time of". The Second Circuit, in a two-to-one opinion rejected the defendant's contention that the proviso required the exclusion of a person who was not a 10 percent owner before each of the transactions involved. Instead, the Court based its decision on the interpretation of the proviso adopted by the district court and supported by the SEC in an amicus brief, that a 10 percent stockholder need only be such simultaneously with each transaction; that is, just after a purchase or just before a sale.[13]

Courts having the occasion to interpret the Securities Act with regard to questions other than the precise one we have before us have generally held that the Act should be liberally construed to carry out the express legislative policy.[14]

While the problem of interpretation is difficult and not free of all doubt, we are persuaded that in the case

---

[13] To the contrary, see, *Arkansas Louisiana Gas Co. v. W. R. Stephens Investment Co.*, 141 F.Supp. 841 (W.D. Ark. 1956).

[14] See *Cresswell-Keith, Inc. v. Willingham*, 264 F.2d 76, 80 (8th Cir. 1959). See, *Western Auto Supply Co. v. Gamble-Skogmo, Inc.*, 348 F.2d 736, 743 (8th Cir. 1965), where we stated, "The Supreme Court in *Blau v. Lehman*, 368 U.S. 403, 414, 82 S.Ct. 451, 7 L.Ed.2d 403 (1962), speaks of the 'prophylactic' effect Congress clearly prescribed in § 16(b). Other cases cited in this opinion refer to § 16(b) as being 'remedial', 'broadly remedial', 'thorough-going', and 'absolute' and strictly construing the statute against the insider in order to effectuate its wholesome purpose."

before us the District Court reached the right result in its holding that the purchase by which one becomes a more than 10 percentum stockholder, where followed by a sale within six months of some or all of the purchased security makes the purchaser a more than 10 percentum beneficial owner within the meaning of Section 16(b) "both at the time of the purchase and sale." We endeavor to give our reasons for reaching this result.

We are persuaded that the Congressional intent, albeit broad and not as clear as desirable, was to authorize recovery of any realized profit by directors, officers and certain large stockholders who engaged in short-swing transactions (six months or less) of sale and purchase or purchase and sale. The intent as to such short-swing transactions was to stop the *possible,* not the actual—for that was considered to be too difficult to prove—use of inside information.[15] It is clear that Section 16(b) applies to every more than 10 percentum beneficial owner without regard to his factual access to or possession of inside information. The statute speaks only of more than 10 percentum beneficial owners and not of "insiders". It does not require inside knowledge or bad motive. It is also

---

[15] Actual culpability is not required of the narrow class of persons to which Section 16(b) applies. As said by Judge Learned Hand in *Gratz v. Claughton,* 187 F.2d 46, 49-50 (2nd Cir. 1951), cert. den. 341 U.S. 920 (1951): "The section does indeed cover trading by those who in fact have no such information, ... If only those persons were liable, who could be proved to have a bargaining advantage, the execution of the statute would be so encumbered as to defeat its whole purpose." See, also, *Western Auto Supply Co. v. Gamble-Skogmo, Inc., supra* at 743, "We cannot have one rule for insiders with good intentions and another for those who would flagrantly abuse their trust. The burden of the Act must fall on all violations with equal weight." Thus, Section 16(b) is viewed as not penal requiring intent to misuse inside information but simply remedial to remove the right to retain profits obtained while in the advantageous position the statute describes.

sufficiently clear that Congress intended that Section 16(b) apply to only those or only to that class recognized by the 16(b) statutory language as generally having the opportunity of obtaining inside information, and that more than 10 percent security holders were deemed by Congress to be of that class.[16]

Thus, to carry out the general purpose Congress sought by enactment of the statute, having in mind that at least to some degree that language is not free of ambiguity, we have concluded that the purchase by which a security holder acquires a more than 10 percentum status is included as a part of a pair of transactions of purchase and sale occurring within six months of each other within the meaning of Section 16(b). Any other view has the weakness of impracticability of application of the statute, a result we should not lightly attribute to a Congress striving to prevent what it considered to be highly undesirable speculations by certain security owners who are in position to obtain or to be exposed to that kind of inside information lending itself to speculative use to the possible detriment of the public.

Illustrative of some of the mischief that would be permitted in spite of Congress' action in enacting 16(b) if we accorded with Emerson's contentions is an initial purchase of as large a block of stock as 51 percent or more of a corporation's stock, followed by a sale any time

---

[16] "The corporation is thus provided with a method of recoupment from insiders profits realized either through purchases of an equity security followed by its sale at a higher price; or from sale of an equity followed by a purchase at a lower price within the six month period. Once the statutory conditions have been fulfilled, it is irrelevant that the insider either did not make unfair use of inside information or that he might not have intended, at the time he purchased the security, to sell it within six months." Painter, Federal Regulations of Inside Trading, Chpt. III, pp. 24-25 (1968).

within six months by the stockholder who obviously within that period could obtain much inside information and also could influence, manipulate or control corporate transactions. The deterrence of such apparent potential mischief must have been within the contemplation of Congress.[17]

Nor does the fact that Emerson acquired its stock in an effort to merge with Dodge and sold it after such merger appeared no longer possible exempt Emerson from the ambit of Section 16(b). An insider engaged in a contest for control of its stock issuer may have substantial opportunity for short-term profits perforce of its substantial stock ownership. In less than three months from its stock purchase Emerson apparently had made substantial short term profits related to its stock acquisition activities in its effort to gain stock control of Dodge.[18]

We reach the last question of the present appeal; namely, whether Emerson's sale of 115,282 shares of stock on September 13, 1967, within six months of its acquisition of 13.2 percent of Dodge's stock, but at a time when Emerson had reduced its stock holdings to below 10 percent of Dodge's stock, is a transaction where the beneficial owner was a more than 10 percent beneficial

---

[17] One notorious example before Congress concerned brothers who within a short time before company passed a dividend sold their stock for $16,000,000 and after the dividend became public repurchased an equivalent amount for $7,000,000. See: S. Rep. No. 792, 73rd Cong., 2nd Sess. 9 (1934).

[18] See: Note, Insider Trading: The Issuer's Disposition of an alleged 16(b) Violation, 1968 Duke L.J. 94, 97. "Section 16(b) often imposes liability on the 'innocent' insider who has not abused his position since the unfair use of confidential information by insiders or the intent to profit by its use is irrelevant to the question of liability under section 16(b)." *Petteys v. Butler*, 367 F.2d 528 (8th Cir. 1966), cert. den. 384 U.S. 1006 (1967); *Smolowe v. Delendo Corp.*, 136 F.2d 231 (2 Cir. 1943), cert. den. 320 U.S. 751 (1943).

owner both at the time of the purchase and sale within the intendment of Section 16(b). The District Court found that while Emerson was the beneficial owner of 13.2 percent of Dodge shares it determined to dispose of its entire stock holdings pursuant to a plan whereby it hoped to avoid, to the extent possible, Section 16(b) liability for short term profits. Pursuant to that determination it made the mentioned two separate sales not tied in any legal way to each other.

Insofar as we are advised the question presented by the second sale is one of first impression. Our review of the record indicates the District Court's finding as a fact that Emerson made two separate sales not legally tied together in any way, with the described intent to avoid losing its profit on its second sale because of possible Section 16(b) applicability, is not clearly erroneous, and is supported by substantial evidence. The factual question as to whether a particular sale is a separate and independent sale is a matter for decision under the peculiar facts of the particular case. In this regard each case must stand or fall on its own facts.

However, there is no reason why a person may not conduct his business in such a way as to intentionally minimize or eliminate his loss of profits under Section 16(b) by any means permitted by law. Such conduct is to some extent analogous to tax avoidance conduct which is permissible.[19] We, therefore, do not fault Emerson for its

---

[19] See *Helvering v. Gregory*, 69 F.2d 809, 810 (2nd Cir. 1934): ". . . A transaction, otherwise within the exception of the tax law, does not lose its immunity, because it is actuated by a desire to avoid, or, if one choose, to evade, taxation. One may so arrange his affairs that his taxes shall be as low as possible . . . ." On appeal, the Supreme Court affirmed saying: "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted." *Gregory v. Helvering*, 293 U.S. 465, 469 (1934).

effort to avoid the total loss of profits on its 152,282 shares of stock by first reducing its holdings by means of a bona fide sale to below 10 percent, and then in a later, independent bona fide sale while owning less than 10 percent, dispose of its remaining shares.

Concededly, Congress through Section 16(b) did not endeavor to deny profits resulting from all insider transactions. Stock held one day more than six months before being sold escaped Section 16(b) regulation entirely. Stock amounting to a bare fraction less than the "more than 10 percentum" likewise escaped Section 16(b) entirely. The standards set forth in Sections 16(a) and 16(b) are arbitrary both in the selection of time, 6 months, and the selection of amount, more than 10 percentum. A security transaction either falls within or without the scope of Section 16(b) depending on whether these arbitrary standards are met.[20] A security holder such as Emerson does suffer some detriment albeit small in its two short-swing transactions in that it does lose its profit acquired from its first sale, made while it was a more than 10 percentum security holder. After that sale the arbitrary standards enacted by Congress in 16(b) of a "more than 10 percentum" security holder are no longer met, and subsequent sales appear to be free of Section 16(b) regulation. Such subsequent sales literally fall within the exemption language of 16(b): "[T]his subsection shall not be construed to cover any transaction where such bene-

---

[20] Some scholars note a recent trend to be more realistic and less formalistic in applying 16(b), especially in defining what is a sale, a purchase, and a transaction within the ambit of the Act. See, Lowenfels, Section 16(b): A New Trend In Regulating Insider Trading, 54 Corn. L. Rev. 45 (1968); *Petteys v. Butler*, 367 F.2d 528 (8th Cir. 1966), cert. den. 385 U.S. 1006 (1969); *Blau v. Lamb*, 363 F.2d 507 (2nd Cir. 1966), cert. den. 385 U.S. 1002 (1967).

ficial owner was not such both at the time of the purchase and sale . . . ."

Since we have determined as a matter of law that intent as such to avoid loss of realized profits by engaging in two independent sales not legally tied to each other and made at different times to different buyers such as these described above, does not result in treating the two sales as one sale of the entire stock held, nor as one continuous transaction, we look to 16(b) to determine whether the second sale was a sale otherwise proscribed by that section. While we agree that Section 16(b) is to be broadly and liberally construed to achieve the intent of Congress, we are unable to discern from any of the Congressional hearings or from the broad basic purpose of 16(b) any intent on the part of Congress not to mean what it has literally said in the 16(b) exclusion clause, giving the words used in that clause a liberal and reasonably flexible meaning. We are not free under the guise of statutory interpretation to rewrite statutes so as to include matters which for unexpressed reasons Congress did not include.[21] We believe it clear that this second and independent sale of September 13 was not made at the time Emerson was a more than 10 percentum stockholder, whether the phrase "at the time of" be viewed as meaning immediately before, simultaneously with or immediately after the 10 percentum stockholder status. Hence, Emerson is not required to pay over to Reliance any profits realized from that sale.

---

[21] It is noteworthy the preamble was in none of the bills on which public hearings were held. The bill submitted to the House by the Committee on Interstate and Foreign Commerce completely omitted the future 16(b). The bill submitted by the Banking and Currency Committee to the Senate was the first to contain the preamble. See, S. Rep. 3420, 73rd Congress, 2nd Sess., 16(b) 1934; Note, Short-Swing Profits and the Ten Percent Rule, 9 Stan. L. Rev. 582, 586, N. 23 (1957).

Accordingly, we remand this cause to the District Court with directions to proceed in accordance with the views expressed herein.

IT IS SO ORDERED.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit.

APPENDIX B.

Judgment of the Court of Appeals.

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT.

No. 20014. September Term, 1970.

EMERSON ELECTRIC CO.,
Appellant,

vs.

RELIANCE ELECTRIC COMPANY,
Appellee.

Appeal from the United States District Court
For the Eastern District of Missouri.

(November 12, 1970.)

Appeal from the United States District Court for the Eastern District of Missouri.

This Cause came on to be heard on the record from the United States District Court for the Eastern District of Missouri and was argued by counsel.

On Consideration Whereof, it is now here ordered and adjudged by this Court that this Cause be and it is hereby remanded to the said Distr Court with directions to proceed in accordance with the views expressed in the opinion of this Court this day filed herein.

APPENDIX C.

Opinion of the District Court.

IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MISSOURI,
EASTERN DIVISION.

No. 68 C 87 (3).

EMERSON ELECTRIC CO.,
Plaintiff,

vs.

RELIANCE ELECTRIC COMPANY,
Defendant.

MEMORANDUM OPINION.

In this case, tried to the Court, plaintiff seeks a declaratory judgment concerning its liability, if any, to defendant for profits realized on the sale of certain stock. Defendant has counterclaimed for the amount of the profits. The issue of profits has been postponed pending the resolution of the issue of liability. We have diversity jurisdiction.

For determination is the construction and application of Section 16(b) of the Securities Exchange Act of 1934 (Section 78p(b), 15 U.S.C.) to the peculiar facts of this case. Most of the essential facts have been stipulated. On May 22, 1967, Emerson Electric Company invited tenders of up to 550,000 shares of Dodge Manufacturing Corporation common stock at a price of $63, reserving the right to purchase all shares tendered. As extended, the tender offer expired June 16, 1967. At that time,

Emerson elected to purchase all of the tendered shares, a total of 152,282. These shares constituted 13.2% of the outstanding Dodge common stock. Prior to June 16, 1967, Emerson did not own any shares of Dodge common stock.

Shortly before the stock acquisition by Emerson, Dodge and Reliance Electric & Engineering Company (now Reliance Electric Company) had entered into an agreement whereby Dodge was to be merged into Reliance. Emerson sought to prevent the merger, which needed stockholder approval, advocating instead a merger with Emerson. A stockholders' meeting to consider the merger proposal was called for August 22, 1967. A proxy fight ensued, the result of which was victory for Reliance. Shortly thereafter, but prior to the final approval of the merger by the Dodge directors, Emerson sold its Dodge holdings. It first sold 37,000 shares at $68 a share on August 28, 1967 to Goldman, Sachs & Company, investment brokers. Then, on September 11, 1967, it sold the remaining 115,282 shares at $69 to Dodge. Concededly, Emerson realized a substantial short-term profit on these sales even after deducting all of its expenses of purchase and sale.

Section 16(b) provides, inter alia, that any profit realized by the beneficial owner of more than 10% of certain equity securities from the purchase and sale (or sale and purchase) within any period of less than six months shall inure to and be recoverable by the issuer. The statute further provides:

> "This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved * * *."

The initial question for determination is whether Emerson was a beneficial owner of more than 10 per cent

of Dodge common stock "at the time of the purchase" of such stock. Emerson states the question thusly: "Should the very purchase by which one, who prior thereto owns no securities of an issuer, becomes a 10% owner be counted in determining liability for insider short-swing profits?" It argues that in the context of the Act, the words "at the time of purchase" can mean only "before the purchase" and that since Emerson owned no Dodge securities prior to June 16, 1967, and had no access of "inside" information, it may not be subjected to Section 16(b) liability. We do not agree.

Passing for the moment Emerson's further contention that its acquisition of the stock was not a "purchase" within the meaning of the Act, we are convinced that "at the *time* of purchase" includes the time "simultaneously with" the purchase, so that a shareholder becomes subject to the provisions of Section 16(b) immediately upon (that is, at the very moment of) his acquisition of more than 10 per cent of the corporation's stock. This construction accords not only with the literal meaning of the language, but more importantly, best serves to effectuate the legislative purpose manifest in Section 16(b). Accord: *Stella v. Graham-Paige Motors Corporation*, D.C.N.Y., 104 F. Supp. 957, affirmed (on this point) 2 Cir., 232 F.2d 299, cert. den. 352 U.S. 831. See Cook & Feldman, Insider Trading Under the Securities Exchange Act, 66 Harvard Law Review 612, 631-632.

Emerson urges, however, that although the transaction by which it acquired more than 10 per cent of Dodge stock was in fact a "purchase" (and indeed, under any view, a cash acquisition of this nature, could not be otherwise) nevertheless it was not a "purchase" of the kind contemplated by Section 16(b). Its theory is that each case must be examined on its own peculiar facts

(*Petteys v. Butler*, 8 Cir., 367 F.2d 538), and that since the only evidence of record is to the effect that Emerson had no access to and had not acquired "insider" information prior to the purchase, its acquisition of a 13.2 per cent interest was not one that could have lent itself to the practices Section 16(b) was enacted to prevent. Again, we do not agree.

We do not believe that Congress intended to exclude any transaction which is undeniably a purchase under any concept thereof. In the cases in which the facts were examined by the courts, the issue was whether a particular transaction which did not involve a purchase (or a sale) within the ordinary understanding of those terms, e.g. conversions and reclassifications of stock, was a purchase (or a sale) as defined by Section 3 of the Act. It was to aid in resolving problems of that nature that the courts have created the following test or standard: "Every transaction which can *reasonably be defined as a purchase* will be so defined, if the transaction is of the kind which can possibly lend itself to the speculation encompassed in Section 16(b)" *Ferraiola v. Newman*, 6 Cir., 259 F.2d 342, 345. This is the test applied by the Eighth Circuit. *Petteys v. Butler*, 8 Cir., 367 F.2d 568.

Petteys involved a conversion transaction and the Court held that under the "unique facts" of that case the conversion of convertible preferred stock to common stock by non-controlling directors was not a purchase within the purview of the Act even though it might "represent a type of exchange of equivalents that can be read into a literal interpretation of the § 16(b) language of 'otherwise acquire' and 'otherwise dispose of' ". What *Petteys* ruled is succinctly summarized by Judge Gibson as follows (367 F.2d, l. c. 356): "If no purpose is served by attaching the *artificial label* of 'purchase' to a transaction, when it has

none of the common indicia of a purchase, no such label is demanded, nor will one be attached. This, we believe to be the correct law and it is the law to be applied by us to the facts of this case."

In the instant case, no artificial label of "purchase" is attempted. The transaction by which Emerson acquired the Dodge stock has all the "common indicia" of a purchase. Here, we do not have an "otherwise acquire" situation, but rather, a simple, conventional acquisition of stock for cash.

We hold that the transaction was a purchase under any view of the facts. By such purchase, Emerson "elected to become a statutory fiduciary", thereby becoming subject "to the disciplinary purpose of § 16(b)", *Western Auto Supply Company v. Gamble-Skogmo, Inc.*, 8 Cir., 348 F.2d 736, regardless of the actual availability or use of inside information. The possibility of insider abuse is inherent in every such transaction. The expressed purpose of the statute is to prevent the unfair use of information which *may* have been obtained by the beneficial owner. Clearly, Section 16(b) is applicable to Emerson's August 28, 1967 sale for cash of 37,000 shares of Dodge stock.

The basis on which Emerson disclaims liability as to said sale is that it was "forced" to dispose of these shares because of the foregone conclusion that the Dodge-Reliance merger would be approved very shortly with the result that the consummation of the merger would, so it is claimed, be treated as a sale of the Emerson-held Dodge shares in exchange for shares of Reliance. We are not convinced that the exchange of shares incidental to the merger would necessarily involve a "sale" of the Dodge stock held by Emerson. The cases cited by Emerson on this point go no further than to hold that for purposes of

the *anti-fraud* provisions of the Act, the acquisition of new stock for the old, resulting from a statutory merger, is deemed a purchase and sale. *Dasho v. Susquehanna Company*, 7 Cir., 380 F.2d 262. And see *SEC v. National Securities, Inc.*, 393 U.S. 453. Thus, in the *SEC* case, the Supreme Court noted that the meaning of particular phrases in statutes must be determined in context and that the same words may take on a different coloration in different sections of the securities laws. The Court stated, "We must therefore address ourselves to the meaning of the words 'purchase or sale' in the context of §.10(b). Whatever these or similar words may mean in the numerous other contexts in which they appear in the securities laws, only this one narrow question is presented here." And again, "Whatever the terms 'purchase' and 'sale' may mean in *other* contexts, here an alleged deception has affected individual shareholders' decisions in a way not unlike that involved in a typical cash sale or share exchange. The broad anti-fraud purposes of the statute and the rule would clearly be furthered by their application to *this* type of situation."

Hence, it is not at all certain that in the context of Section 16(b) the word "sale" would be construed to include the involuntary exchange by Emerson of the Dodge shares for those of Reliance pursuant to the merger. Inasmuch as such a transaction is an "otherwise dispose of" situation, and not a typical or conventional sale, the rationale of *Petteys, supra*, would undoubtedly require an examination of the "unique" facts of the case to determine whether the purposes of Section 16(b) would be furthered by attaching the artificial label of "sale" to this type of situation. However, we need not decide whether Emerson would have been liable for Section 16(b) profits had it held the Dodge shares until the merger was con-

summated, since it did not do so and the question is now moot.

Reduced to its essentials, what Emerson is saying is that it should be permitted to retain its short-swing profits resulting from the cash sale of the 37,000 shares of stock, because otherwise it would have been required to account to Reliance for the short-swing paper profits it would have realized upon the consummation of the merger. Yet the very purpose of Section 16(b) is to prevent the retention of such short-swing profits. Under any view of the case, Emerson is liable for Section 16(b) profits on its sale for cash of the 37,000 shares of Dodge stock.

Less obvious is the resolution of the further question: Should Emerson be held accountable for the profits realized on the September 13 sale of its remaining 115,282 shares even though at that time (by reason of its prior disposition of the 37,000 shares) Emerson was the beneficial owner of less than 10% of Dodge shares. We have concluded that under the peculiar facts of this case, Section 16(b) is applicable to the September 13 transaction.

We are convinced that while Emerson was the beneficial owner of 13.2% of Dodge shares, it determined to dispose of its entire stock holdings pursuant to a plan whereby it hoped to avoid, to the extent possible, Section 16(b) liability for short term profits. The guidelines of the plan were formulated in a letter written by its counsel to its board chairman under date of June 26, 1967. In that letter, counsel discussed alternatives to a proxy contest with Reliance, "principally *how* to dispose of, *at a profit*, the shares of Dodge stock which Emerson now owns." He took note of the "uncertainty" whether the very purchase whereby Emerson became the holder of more than 10% of the Dodge stock should be taken into account for Section 16(b) purposes and advised that "Emerson should

proceed on the assumption that 16(b) does apply and *should seek to avoid its consequences.*" It was counsel's opinion that if a merger occurred, Emerson would be considered to have "sold" its Dodge shares for Section 16(b) purposes. On that premise, he outlined "*defensive* action against 16(b) possibilities" which in his opinion should be taken by Emerson: "The *initial* defensive step * * * is for Emerson to reduce its holdings of Dodge stock to less than 10%. This means the gift or sale * * * of 37,100 shares of Dodge stock owned by Emerson. From this point on, Emerson, no longer being a 10% stockowner of Dodge can sell the balance of its Dodge stock free of any 16(b) risks; provided, of course, the second sale is not *legally tied* in any way to the first sale."

Because of the manner in which this case was submitted, the facts were not fully developed, as they might have been through vigorous cross-examination. However, the actions of Emerson when viewed in the light of its counsel's letter, clearly bespeak the fact that although the two sales of Dodge stock were technically separate transactions and the second sale was not "legally" tied in any way to the first sale, the two sales were effected pursuant to a single pre-determined plan of disposition with the overall intent and purpose of avoiding Section 16(b) liability. Emerson's initial sale of 37,000 shares[1] was motivated solely by its desire to reduce its holding to just under 10% immediately prior to disposing of the balance of its shares in an attempt to escape Section 16(b) liability on the short-swing profits it contemplated would be made upon such remaining shares. Significantly, the negotia-

---

[1] An increase in the number of Dodge outstanding shares made it necessary to sell only 37,000 instead of 37,100 shares as suggested in counsel's letter in order to reduce Emerson's holdings to less than 10%

tions with Reliance commenced just one day after Emerson agreed by telephone conversation to sell the initial 37,000 shares to Goldman, Sachs & Company, and the agreement for the sale was tentatively arrived at one week thereafter subject only to the formalizing of the understanding. The timing was not a happenstance. That the negotiations with Reliance for the sale of the Emerson-held Dodge shares were initiated by Reliance does not affect our conclusion that the two sales were in fact interrelated parts of a single plan. In fact, in his June 26 letter, Emerson's counsel had anticipated the possibility of a settlement under a negotiated agreement providing for the purchase of the Dodge shares owned by Emerson, the settlement to provide for a sale by Emerson of at least 37,100 of its Dodge shares before the merger was approved by the stockholders.

Looking through form to discern substance, we hold that in truth and in fact the two sale transactions were related parts of a single plan devised by Emerson to dispose of all its Dodge stock in an attempt to "avoid the consequences" of Section 16(b). Emerson may not thus insulate from Section 16(b) liability the short-term profits derived from its disposition of the Dodge stock. To sanction this two-step sale procedure would be to subvert the purposes of Section 16(b) and to produce a result plainly at variance with its manifest policy. Unless appearances are to control, rather than reality, we believe that for purposes of this case the "time of sale" should include the entire period during which a series of related transactions take place pursuant to a plan by which a 10% beneficial owner disposes of his stock holdings.

We do not question the good faith of Emerson or its counsel. What we do question is its right to excise 16(b) liability or "avoid its consequences" by utilizing a series

of related transactions, some of which considered separately might be exempt, when the obvious substance of the transaction as to a whole is the disposition of its more than 10% beneficial interest.

We hold that Emerson is liable to Reliance, as the successor in interest to Dodge, for the net profits realized by Emerson from the sale of all its 152,282 shares of Dodge stock. Counsel for Reliance are directed to submit a form of interlocutory declaratory judgment in accordance herewith.

The foregoing memorandum constitutes our findings of fact and conclusions of law on the issue of liability.

Dated this 18th day of September, 1969.

/s/ JOHN K. REGAN,
United States District Judge.

APPENDIX D.

Judgment of the District Court.

IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MISSOURI,
EASTERN DIVISION.

No. 68 C 87 (3)

EMERSON ELECTRIC CO.,
Plaintiff,

vs.

RELIANCE ELECTRIC COMPANY,
Defendant.

INTERLOCUTORY DECLARATORY JUDGMENT.

This cause came on to be heard by the Court on the pleadings, the evidence presented at trial, and the written stipulation and briefs of counsel for the parties, and the Court, being fully advised in the premises, finds the facts and law to be as set forth in its memorandum opinion dated September 18, 1969 and, accordingly, it is

ORDERED, ADJUDGED AND DECREED:

1. That plaintiff Emerson Electric Co. is liable to defendant Reliance Electric Company for the net profits realized by plaintiff from the sales of 152,282 shares of stock of Dodge Manufacturing Company on August 28 and September 13, 1967.

The Court is of the opinion and therefore finds that this order involves controlling questions of law as to which there is substantial ground for difference of opinion and that an immediate appeal from this order under Title 28

U.S.C.A. § 1292(b) may materially advance the ultimate termination of this litigation.

IT IS HEREBY FURTHER ORDERED that this matter be certified under Title 28 U.S.C.A. § 1292(b) and that all proceedings in this cause be stayed pending the final action of the United States Court of Appeals for the Eighth Circuit.

Dated this 9th day of October, 1969.

/s/ JOHN K. REGAN,
United States District Judge.

LIBRARY
SUPREME COURT, U.S.

Supreme Court, U.S.
FILED
MAR 8 1971
E. ROBERT SEAVER, CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1970

70-79

No. ~~1332~~

RELIANCE ELECTRIC COMPANY,
Petitioner,

v.

EMERSON ELECTRIC COMPANY,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

R. H. McROBERTS
THOMAS C. WALSH
1600 Boatmen's Bank Building
St. Louis, Missouri 63102
Attorneys for Respondent

BRYAN, CAVE, McPHEETERS & McROBERTS
Of Counsel

St. Louis Law Printing Co., Inc., 411-15 N. Eighth St. 63101 314-231-4477

INDEX

	Page
Opinion below	1
Questions presented	1
Statement of facts	3
Reasons why the writ should not be granted	8
Conclusion	15

CITATIONS

Cases Cited

Adler v. Klawans, 267 F. 2d 840, 845 (2d Cir. 1959) ..11, 12

Bershad v. McDonough, 428 F. 2d 693 (7th Cir. 1970) 14, 15

Blau v. Lehman, 368 U.S. 403 (1962) 14

Helvering v. Gregory, 69 F. 2d 809 (2d Cir. 1934) affirmed 293 U.S. 465 (1935) 14

United States v. Isham, 84 U.S. [17 Wall] 496 (1873) 14

Statutes Cited

15 U.S.C., § 78 ..... 3, 8

28 U.S.C., § 1292(b) 6

Securities Exchange Act of 1934:

Section 10(b) 10, 14

Section 14 8

Section 16(b) ...1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15

Miscellaneous Cited

Katz, "Short-Swing Liability" The Review of Securities Regulation, Vol. 2, No. 8 (April 16, 1969) 12

Seligman "Problems Under the Securities Exchange Act," 21 Va. L. Rev. 1, 20 (1934) 13

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1970

No. 1332

RELIANCE ELECTRIC COMPANY,
Petitioner,

v.

EMERSON ELECTRIC COMPANY,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

OPINION BELOW

The opinion of the United States Court of Appeals for the Eighth Circuit is now reported at 434 F. 2d 918.

QUESTIONS PRESENTED

I. May a Corporation

(a) which is not an "insider" in fact,

(b) but which has become a technical "insider" under Section 16(b) of the Securities Exchange Act of 1934, by its acquisition of more than 10% of a

listed issuer's capital stock, pursuant to an unsuccessful tender offer,

(c) when such corporation finds itself about to be forced into an involuntary "sale" of such stock, within six months of its purchase, by reason of a merger of the issuer into another corporate entity,

In Good Faith Minimize the Section 16(b) Consequences of the Theatened Involuntary "Sale"

(d) by first selling sufficient stock of the issuer, in a bona-fide sale, to reduce its holdings to less than 10%, and

(e) thereby cease to be a technical "insider" under Section 16(b), and

(f) thereafter sell the remainder of its stock, in a second and unconnected bona-fide sale, free from Section 16(b) liability?

II. Does the Proviso to Section 16(b) Stating That "This Subsection Shall Not Be Construed to Cover Any Transaction Where Such Beneficial Owner Was Not [the Beneficial Owner of More Than 10 Per Centum] Both at the Time of the Purchase and Sale" Mean What It Says?

STATEMENT OF FACTS

Petitioner seeks review of the unanimous decision of the three-judge panel of the Court of Appeals for the Eighth Circuit denying recovery under the short-swing profit provisions of Section 16(b) of the Securities Exchange Act of 1934, (15 U.S.C. § 78 p (b)) for the profits realized by Respondent from the sale of stock of the issuer on September 13, 1967, at which time it is conceded that Respondent owned less than 10% of the issuer's stock. Petitioner's version of the facts is incomplete and inadequate to depict accurately the unusual circumstances out of which this case arose.

On May 22, 1967, Respondent Emerson Electric Co. ("Emerson") announced in the public and financial press an offer to purchase up to 550,000 shares of the common stock of Dodge Manufacturing Corporation ("Dodge") from Dodge shareholders. At no time prior to this tender offer did Emerson own any shares or other securities of Dodge. Dodge management vigorously contested Emerson's tender offer and urged its shareholders to reject the offer. On May 25, Dodge publicly and unexpectedly announced an agreement in principle to merge with Petitioner, Reliance Electric Company ("Reliance").

Dodge filed suit against Emerson in federal court in Indiana to prohibit Emerson from accepting any tenders or further pursuing its tender offer. In its complaint, Dodge charged Emerson, *inter alia,* with harassment, with making derogatory statements about Dodge and with misusing confidential information acquired from Dodge. The District Court refused to issue a temporary injunction and, in its Memorandum Opinion, the court specifically absolved Emerson of wrongdoing and found that Emerson did not have any confidential information about Dodge and that

all its knowledge concerning Dodge had been gleaned from publicly available sources.

On June 16, 1967, the tender offer expired, and Emerson purchased all of the shares tendered by the Dodge stockholders, totaling 152,282 shares. The shares so purchased represented 13.2% of the outstanding Dodge common stock.

Emerson then decided to make a counter-proposal, in opposition to the Reliance merger offer, that Dodge be merged into Emerson. Dodge management firmly and consistently opposed the Emerson proposal, and Emerson was eventually required to file suit to obtain the shareholders' list.

A special meeting of the Dodge shareholders was called for August 22, and a lively proxy contest ensued between Dodge and Emerson. Dodge persisted in its opposition to Emerson, and Emerson was again forced to file suit to prevent Dodge from denying Emerson access to shareholders and for making false and misleading statements about Emerson's merger proposal. At the Dodge shareholders' meeting on August 22, the Emerson plan was rejected, and the Reliance merger was approved, to become effective on or about September 30, 1967.

During the proxy contest between Emerson and Dodge, Emerson and its counsel were well aware of Section 16(b), of the fact that Emerson had, on June 16, 1967, become the holder of more than 10% of the common stock of Dodge, and of the fact that if the Dodge-Reliance merger should be consummated, Emerson would probably be considered to have "sold" these shares, within six months, for Section 16(b) purposes.

Under date of June 26, 1967, counsel gave Emerson a formal opinion discussing both tax and Section 16(b) con-

siderations arising out of Emerson's acquisition of 152,282 shares of Dodge stock. After pointing out the tax disadvantages to Emerson of realizing short-term versus long-term capital gains on any sale of such shares, counsel discussed the possible impact of Section 16(b) upon any profits which Emerson might realize and concluded that "it is important for Emerson to reduce its holdings of Dodge stock to less than 10% prior to the Dodge stockholders' meeting."

Following counsel's recommendation, Emerson, on or about August 22, 1967, initiated negotiations with Goldman, Sachs & Co. for the sale of 37,000 shares of Dodge stock. The sale, made on the New York Stock Exchange, was consummated on August 28, 1967 and reduced Emerson's holdings in Dodge to less than 10%.

On August 29, 1967, *Reliance*, on behalf of Dodge, *initiated discussions with Emerson* for the purchase by Dodge of the remaining 115,282 shares from Emerson. Prior to such time, Emerson had not offered to sell any of such shares and had made no decision to sell them. Negotiations continued and, on September 11, 1967, a comprehensive purchase agreement was entered into between Dodge and Emerson for the sale to Dodge of the 115,282 shares. The purchase agreement was consummated and closed according to its terms on September 13, 1967. On September 29, 1967, Dodge merged into Reliance, with Reliance emerging as the surviving corporation, and Dodge stockholders received shares of Reliance in exchange for their Dodge stock.

In the purchase agreement dated September 11, 1967, and several times thereafter, Reliance made the representation and expressed the opinion that the profits realized by Emerson on the sale to Dodge of the 115,282 shares on September 13, 1967 were not subject to Section 16(b) be-

cause Emerson indisputably was not then the owner of more than 10% of the Dodge stock.

After a demand by a Reliance shareholder, however, Reliance wrote to Emerson on February 13, 1968, demanding that Emerson pay to Reliance the net profits, after expenses, realized by Emerson on the sale of 37,000 shares of Dodge stock on August 28. Reliance again specifically stated that, in its opinion, the profits which Emerson made on the September 13th sale were not recoverable by Reliance, since Emerson at that time was not the owner of more than 10% of the outstanding stock of Dodge.

Emerson denied all liability under Section 16 (b) on the grounds that it did not own any Dodge stock "at the time of the purchase" of the 152,282 shares on June 16, and was thus expressly exempted from liability on either sale. Faced with this controversy, Emerson filed a complaint for a declaratory judgment in the District Court, requesting a declaration of its rights and/or obligations under Section 16(b). Reliance filed an answer and counterclaim, praying for judgment against Emerson in the total net amount of Emerson's profits not only on the sale of 37,000 shares of Dodge stock on August 28 but also on the sale of 115,282 shares of Dodge stock on September 13.

After a trial to the court on the issue of liability only, the District Court held Emerson liable for its net profits on both sales. The court concluded that Emerson should be held accountable for the profits realized on the second sale even though it expressly found that "at the time (by reason of its prior disposition of the 37,000 shares) Emerson was the beneficial owner of less than 10% of Dodge shares." Recognizing the novelty of this holding, the court certified the case for interlocutory appeal under 28 U.S.C., § 1292(b).

The Court of Appeals reversed on this issue, holding, under the peculiar facts of this case, that the statute must

be interpreted according to its clear language and that, therefore, the second and independent sale of September 13 was not made at a time when Emerson was more than a 10% stockholder of Dodge and was thus free from the proscriptions of Section 16(b).[1]

---

[1] The district court rejected Emerson's contention that it should not be held liable for any profits on either sale because it owned no Dodge stock "at the time of the purchase" of 13.2% on June 16, 1967. The Court of Appeals affirmed this holding, thus requiring Emerson to pay to Reliance the profits from the sale of 37,000 shares on August 28. Of course, if certiorari is granted, the issue will be presented as to whether Emerson was the owner of more than 10% "at the time of the purchase" as well as "at the time of the [second] sale."

REASONS WHY THE WRIT SHOULD NOT BE GRANTED

Both the District Court and the Court of Appeals recognized that this case is one of first impression. The District Court based its decision on "the peculiar facts of this case."[2] The Court of Appeals also noted that an *ad hoc* approach is necessitated by factual variations in Section 16(b) cases:

> "The factual question as to whether a particular sale is a separate and independent sale is a matter for decision under the peculiar facts of the particular case. In this regard each case must stand or fall on its own facts." 434 F. 2d at 925.

Although the Securities Exchange Act has been in force for 37 years, the issue presented by this case has never before arisen. Therefore, of course, there exists no conflict between the decision of the Eighth Circuit below and any ruling of this Court or of any other Circuit. Although this case is important to the parties, it contains nothing of general interest or importance because of its circumscription by its own facts. None of the considerations enumerated in this Court's Rule 19 are present to warrant the exercise of this Court's certiorari power or to justify the usurpation by this case of valuable space on this Court's docket.

The unusual predicament in which Emerson found itself inextricably trapped resulted solely from the tender offer and the defensive tactics employed by Dodge and Reliance to thwart Emerson's contemplated marriage to Dodge.

This case arose in 1967, when tender offers were in vogue, primarily because they were unregulated by the Securities and Exchange Commission. In 1968, however, Section 14 of the Act (15 U.S.C., § 78n) was amended to require the

---

[2] See 306 F. Supp. at 591.

filing with the Commission of all tender offers for the stock of registered companies. Since the effective date of these amendments, the tender offer has suffered a marked decline in glamour and popularity. Moreover, the mechanism provided by the 1968 amendments to Section 14 contains safeguards to prevent the emergence of the "corporate triangle," such as the acrimonious Emerson-Dodge-Reliance encounter that caused Emerson's dilemma and precipitated this case.

There is no contention, and there can be none, that Emerson had access to, or in any way capitalized on, any inside information relative to Dodge. If the Court of Appeals was correct in holding that Emerson's initial purchase of 13.2% of Dodge stock subjected it instantaneously to Section 16(b), the impediments inherent in such status are not imposed because of actual privity to inside information but rather because of an arbitrary, but conclusive, presumption of such access. It is an undisputed fact that Emerson was a bitterly resented and repeatedly spurned outsider, as is witnessed by the three lawsuits between Dodge and Emerson. Emerson was a "fiduciary" of Dodge in name only.

It was, in fact, Emerson's lack of voice in Dodge management which enabled Dodge and Reliance to join forces and squeeze Emerson into a quandary, which was occasioned by the scheduled merger of Dodge into Reliance. The exchange of Dodge shares for Reliance shares in the merger would have constituted a "sale" of the Dodge shares owned by Emerson and would presumably have subjected the profits thereon to the forfeiture provisions of Section 16(b).

If it had not been for the impending merger, Emerson probably would have been content to retain its Dodge shares. However, under the circumstances, counsel recommended that Emerson reduce its Dodge holdings to less

than 10% in advance of the Dodge stockholders' meeting scheduled for August 22, 1967.[3]

It was after Emerson's sale of 37,000 shares to Goldman, Sachs had been consummated that *Reliance* broached the subject of Emerson's possible disposition of the remaining shares.

The facts, as found by the District Court and confirmed by the Court of Appeals, conclusively establish that the sale of 37,000 shares to Goldman, Sachs on August 28, and the sale of 115,282 shares to Dodge on September 13, were not "one sale" but were made to different persons, at different times, at different prices, through different mediums, and were separately negotiated by different parties. They were two in form and two in substance.

Reliance's Petition, by implication, ascribes an improper motive to Emerson. But it is clear that neither the District Court nor the Court of Appeals found any such motive. Emerson was simply trying to extricate itself from an adverse predicament not of its own making. If Emerson had misused inside information, Reliance could have pursued it under Section 10 (b) of the Securities Exchange Act. But the question before the Court of Appeals in *this* case was whether the September 13th sale was covered by Section 16(b).

As indisputably revealed by the facts of this case, the issue presented is an esoteric one never before adjudicated and not likely to recur. The Court of Appeals manifestly confined the applicability of its opinion to the unique facts of this case. Other factual nuances, including those hypothesized in Reliance's Petition (p. 8), will have to withstand individual scrutiny if and when they arise.

---

[3] It was subsequently decided that, in view of the provision of the Indiana statutes requiring reapproval of the proposed merger by Dodge directors thirty days after the stockholders' meeting, the sale need not be made prior to August 22.

An additional reason for denying certiorari is that the decision of the Court of Appeals is absolutely correct.

The authors of Section 16(b) recognized the difficulty of proving misuse of inside information, and so they erected arbitrary guidelines to govern transactions by insiders. These guidelines are either observed or they are breached, and the intent of the insider, which is often incapable of ascertainment or proof, will not be examined.

For instance, the Act's six-month holding period is purely arbitrary. There is nothing particularly "magic" about this period of time. Yet Reliance would not contend that if Emerson had held its Dodge stock for six months and one day, simply to avoid the application of Section 16(b), it would be subject to the Act by reason of its intent to avoid liability. It has been specifically held that an insider, even if he notoriously capitalizes on inside information, is not subject to Section 16(b) if he holds his stock for six months and one day.

In *Adler v. Klawans*, 267 F. 2d 840, 845 (2d Cir. 1959), the Court, per Mr. Chief Justice Burger, in speaking of the "harsh" prophylactic nature of Section 16(b), stated as follows:

> "Its bite is sharp only in the limited area of transactions it covers, . . . but for the insider who waits six months and one day after purchase to avoid a short term gain there is no bite at all except as conscience calls the use of inside information on sales after six months as reprehensible as on sales within six months.
>
> * * * * * * *
>
> "Large areas of 'insider' conduct were consciously left untouched by Congress for reasons dictated by practicalities rather than ethics or pure logic. A line had to be drawn somewhere by the lawmakers, as they must do in the laws of marriage, divorce, legitimacy,

real estate, wills and a host of other subjects governed by statute. But the consciously limited scope of the statute is no reason for us to seek yet further limitations of what is remedial legislation."

By the same token, the 10% requirement of Section 16(b) is admittedly arbitrary. As observed above in the quote from *Adler*, "a line had to be drawn somewhere." Persons who are holders of more than 10% are conclusively presumed to be insiders for the purposes of the Act; those with less than 10% at the time of a purchase or sale, no matter how complete their access to inside information, are absolutely exempt from the Act's proscriptions. There is no requirement that one must attain or remain in a 10% status—and therefore be conclusively presumed to be a fiduciary—if he does not desire to do so. He may purchase only 9.9% to obviate the need for filing the reports required by Section 16(a). If he owns more than 10%, he may sell off enough stock to reduce his holdings to less than 10% simply to avoid further regulation by the statute.

There is no contention that Emerson's sale to Goldman, Sachs, which reduced its holdings to less than 10%, was a sham. Emerson without question divested itself of ownership, control and dominion over the 37,000 shares and *ispo facto* ceased to be a statutory insider. It was only after the consummation of the sale that Reliance itself initiated the second sale. It is reasonable to hypothesize that in the absence of Reliance's offer to purchase those remaining shares, Emerson would have been content to exchange them in the merger.

That this type of a situation was not intended to be subjected to Section 16(b) is evident from the following analysis:[4]

---

[4] *Katz*, "Short-Swing Liability" The Review of Securities Regulation, Vol. 2, No. 8 (April 16, 1969).

"[T]he imposition of Section 16(b) liability generally in the context of corporate reorganizations is likely to penalize more innocent persons than those who have gained advantages through actual abuse of insider information. For example, in a period of numerous contests for corporate control by tender offer, unfairness can result if Section 16(b) is automatically applied. Where the management of the target company undertakes a defensive merger with a third company to thwart a tender offer, the tender offeror typically is neither privy to the defensive merger nor apprised of plans for its consummation. Having failed in a bid to gain control through the tender offer, but having obtained enough stock to become a statutory insider, the offeror is locked into securities of a hostile issuer. It may be obliged to dispose of such securities pursuant to a corporate reorganization over which it has no control and with respect to which it obviously has no inside information. *It is fair to say that the imposition of Section 16(b) liability in this context would involve an unjustifiable and probably unintended hardship.*" (Emphasis supplied.)

The proviso to Section 16(b) specifically exempts any transaction in which the owner did not own more than 10% "both at the time of the purchase and sale." It is difficult to conceive of a more explicit exemption for the sale in question here.

As early as 1934, immediately after the passage of the Act, it was recognized that a 10% shareholder could sell enough of his holdings to drop him below 10% and thereafter with impunity, free from the restrictions of Section 16(b), could sell his remaining stock. The Act unequivocally so provides. In *Seligman* "Problems Under the Securities Exchange Act," 21 Va. L. Rev. 1, 20 (1934), the author stated:

> ". . . the intention of the language was to exclude the second sale in a case where 10% is purchased, 5% sold within three months and the remaining 5% a month later. This latter construction of the Act is, it is believed, the only safe one to rely on."

In the only Section 16(b) case ever decided by this Court, *Blau v. Lehman,* 368 U.S. 403 (1962), it was expressly ordered that the Act must be construed as written. This Court observed that if a reading of the plain, unambiguous language of the statute produces what some people might consider to be a "loophole," such matters should be directed to the attention of Congress, not to the courts.[5]

The Court of Appeals analogized Section 16(b) to the tax law, relying on the well-settled principle that a person may conduct his business in a way so as to minimize, or if possible, to eliminate tax liability by any means which the law permits, so long as he does not engage in a sham, subterfuge or fraud. *Helvering v. Gregory,* 69 F. 2d 809 (2d Cir. 1934) *affirmed* 293 U.S. 465 (1935); *United States v. Isham,* 84 U.S. [17 Wall] 496 (1873).

This rule is nothing but a particularization of the universal proposition that every man has the right to conduct his business affairs by all lawful and proper means so as to take advantage of the rights and privileges accorded to him by law, to keep within the limitations, restrictions and prohibitions of the law, and to avoid, by lawful means, the liabilities, forfeitures and penalties imposed by law.

Petitioner erroneously asserts that the decision below is in conflict with *Bershad v. McDonough,* 428 F. 2d 693

---

[5] There is no such "loophole" in the instant case, however, because Emerson was treated exactly the same as any other owner of 9.96% of an issuer's stock. In addition, there is always a remedy available under Section 10(b) to any purchaser or seller who is *actually* victimized by a *true* insider.

(7th Cir. 1970). The *Bershad* case was concerned with determining whether an irrevocable "option" given to a purchaser in consideration for a down-payment of $350,000 was, in effect, a "sale" for purposes of Section 16(b). The Court held that the magnitude of the down-payment, coupled with the seller's granting of an irrevocable proxy to the purchaser and the seller's resignation as an officer and director, insured that the option would be exercised. Thus the Court held "without doing violence to the statute" that the option was a sham and the sale was effectively accomplished as of the "option" date.

The considerations in *Bershad* are inapposite to the instant case. It is *Petitioner's* theory that would require us to "do violence to the statute." Emerson and the Court of Appeals read Section 16(b) to mean exactly what it expressly, unequivocally says.

CONCLUSION

For the reasons stated, the Petition for Certiorari should be denied.

Respectfully submitted,

R. H. McROBERTS

THOMAS C. WALSH
1600 Boatmen's Bank Building
St. Louis, Missouri 63102
Attorneys for Respondent,
Emerson Electric Company

BRYAN, CAVE, McPHEETERS & McROBERTS
Of Counsel

Supreme Court, U.S.
FILED
JUN 3 1971
E. ROBERT SEAVER, CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1970.

No. ~~1222.~~ 70-79

RELIANCE ELECTRIC COMPANY,
Petitioner,

v.

EMERSON ELECTRIC COMPANY,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT.

BRIEF FOR PETITIONER.

THOMAS P. MULLIGAN,
PATRICK J. AMER,
1750 Union Commerce Building,
Cleveland, Ohio 44115,

STEPHEN J. BURNS,
24701 Euclid Avenue,
Cleveland, Ohio 44117,

KENNETH S. TEASDALE,
611 Olive Street,
St. Louis, Missouri 63101,
Counsel for Petitioner.

Of Counsel:
JONES, DAY, COCKLEY & REAVIS,
ARMSTRONG, TEASDALE, KRAMER & VAUGHAN.

THE GATES LEGAL PUBLISHING CO., CLEVELAND, OHIO—TEL. (216) 621-5647

TABLE OF CONTENTS.

OPINIONS BELOW 1

JURISDICTION 1

STATUTE INVOLVED 2

QUESTION PRESENTED 3

STATEMENT OF THE CASE 3

SUMMARY OF ARGUMENT 6

ARGUMENT 7

I. The Two-Step Sales Technique Is a Form of Stock Disposition Which Lends Itself to the Speculative Abuse Section 16(b) Was Designed to Prevent 7

II. Section 16(b)'s "Arbitrary Standards" Do Not Preclude Analysis of the Potential for Abuse in the Factual Situation and Broad and Remedial Construction of the Terms of the Statute 12

III. The Exemptive Provision in Section 16(b) Does Not Exempt the Second of Two Sales Effected Pursuant to a Single Pre-Determined Plan of Disposition 18

A. Emerson's Two Sales Are To Be Treated as One "Sale" Under Section 16(b) 19

B. Section 16(b) Should Apply to Both of Emerson's Sales Transactions Under Substance Over Form Principles and the Step Transaction Doctrine 23

IV. Section 16(b) Should Be Construed as Broadly as Possible to Maintain Fiduciary Standards 28

CONCLUSION 30

TABLE OF AUTHORITIES.

Cases.

Abrams v. Occidental Petroleum Corp., 323 F. Supp. 570 (S.D.N.Y. 1970) 9, 21

Adler v. Klawans, 267 F.2d 840 (2d Cir. 1959) 16, 17

Alaska Industrial Bd. v. Chugach Electric Ass'n, 356 U.S. 320 (1958) 8

American Bantam Car Co., 11 T.C. 397 (1948), *affirmed*, 177 F.2d 513 (3d Cir. 1949), *cert. denied*, 339 U.S. 920 (1950) 25

Anheuser-Busch, Inc. v. Helvering, 40 B.T.A. 1100 (1939), *affirmed*, 115 F.2d 662 (8th Cir. 1940), *cert. denied*, 312 U.S. 699 (1941) 25-26

Bershad v. McDonough, 428 F.2d 693 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971) 14, 20, 21

Blau v. Lamb, 363 F.2d 507 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967) 7, 9

Blau v. Lehman, 368 U.S. 403 (1962) 14, 28

Booth v. Varian Associates, 334 F.2d 1 (1st Cir. 1964), *cert. denied*, 379 U.S. 961 (1965) 10-11, 15

Chemical Fund, Inc. v. Xerox Corp., 377 F.2d 107 (2d Cir. 1967) 14

Colby v. Klune, 178 F.2d 872 (2d Cir. 1949) 14

Commissioner v. Gordon, 391 U.S. 83 (1968) 26

Crowell-Collier Publishing Co., The, Securities Act Release No. 3825 (1957), 1957-61 CCH Fed. Sec. L. Rep. ¶ 76,539 26

Feder v. Martin Marietta Corp., 406 F.2d 260 (2d Cir. 1969), *cert. denied*, 396 U.S. 1036 (1970) 14, 15

Ferraiolo v. Newman, 259 F.2d 342 (6th Cir. 1958), *cert. denied*, 359 U.S. 927 (1959) 19

Gratz v. Claughton, 187 F.2d 46 (2d Cir.), *cert. denied*, 341 U.S. 920 (1951) ---- 28

Great Sweet Grass Oils Ltd., 37 S.E.C. Reports 683 (1957), *affirmed*, 256 F.2d 893 (D.C. Cir. 1958) 26

Gregory v. Helvering, 293 U.S. 465 (1935) ---- 24

King Enterprises, Inc. v. United States, 418 F.2d 511 (Ct. Cl. 1969) ---- 25, 26

LeTulle v. Scofield, 308 U.S. 415 (1940) ---- 8

Loewi v. Ryan, 229 F.2d 627 (2d Cir. 1956) ---- 12

Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545 (1928) ---- 28

Newmark v. RKO General, Inc., 425 F.2d 348 (2d Cir.), *cert. denied*, 400 U.S. 854 (1970) ---- 9, 20

Park & Tilford v. Schulte, 160 F.2d 984 (2d Cir.) *cert. denied*, 332 U.S. 761 (1947) ---- 21

SEC v. Micro-Moisture Controls, Inc., 148 F. Supp. 558 (S.D.N.Y. 1957), *affirmed sub nom. SEC v. Culpepper*, 270 F.2d 241 (2d Cir. 1959) ---- 26

Smolowe v. Delendo Corp., 136 F.2d 231 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943) ---- 10, 28, 29

Stella v. Graham-Paige Motors Corp., 132 F. Supp. 100 (S.D.N.Y. 1955), *affirmed in part*, 232 F.2d 299 (2d Cir.), *cert. denied*, 352 U.S. 831 (1956) 22

Truncale. v. Blumberg, 80 F. Supp. 387 (S.D.N.Y. 1948) ---- 15

United States v. General Geophysical Co., 296 F.2d 86 (5th Cir.), *rehearing denied*, 62-1 U.S.T.C. ¶ 9115 (5th Cir. 1961), *cert. denied*, 369 U.S. 849 (1962) ---- 26

Volk v. Zlotoff, 285 F. Supp. 650 (S.D.N.Y. 1968) 28

Western Auto Supply Co. v. Gamble-Skogmo, Inc., 348 F.2d 736 (8th Cir. 1965), *cert. denied*, 382 U.S. 987 (1966) ---- 11, 13, 28

Statutes.

Securities Exchange Act of 1934:

Sec. 10(b) ---------- 10

Sec. 16(a) (15 U.S.C. § 78p(a)) ---------- 2

Sec. 16(b) (15 U.S.C. § 78p(b)) ---------- 2, *et passim*

Sec. 27 (15 U.S.C. § 78aa) ---------- 4-5

28 U.S.C. § 1254(1) ---------- 1

28 U.S.C. § 1292(b) ---------- 5

Other.

Bittker & Eustice, *Federal Income Taxation of Corporations and Shareholders* 555, 605, 629 (2d Ed. 1966) ---------- 24

General Rules and Regulations under the Securities Exchange Act of 1934, Rule 10b-5 ---------- 10

II Loss, *Securities Regulation* 1087, 1043 (1961) ---- 11

Seligman, "Problems Under the Securities Exchange Act," 21 *Va. L. Rev.* 1, 20 (1934) ---------- 18

Supreme Court Rules 40(1)(d)(2), 40(3) -------- 8

In the Supreme Court of the United States

OCTOBER TERM, 1970.

No. 1332.

RELIANCE ELECTRIC COMPANY,
Petitioner,

v.

EMERSON ELECTRIC COMPANY,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT.

BRIEF FOR PETITIONER.

OPINIONS BELOW.

The opinion of the United States Court of Appeals for the Eighth Circuit, filed on November 12, 1970, is reported at 434 F.2d 918 (A. 170). The memorandum opinion of the United States District Court for the Eastern District of Missouri, filed on September 18, 1969, is reported at 306 F. Supp. 588 (A. 157).

JURISDICTION.

The judgment of the United States Court of Appeals for the Eighth Circuit was entered on November 12, 1970. The petition for writ of certiorari was filed on February 9, 1971, and was granted on April 5, 1971. The jurisdiction of this Court rests on 28 U.S.C. § 1254(1).

STATUTE INVOLVED.

The relevant portions of the text of Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), are as follows:

> Section 16(b). For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner [the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 12 of this title],[1] director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. . . . This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

---

[1] The bracketed words are taken from Section 16(a) of the Securities Exchange Act of 1934, 78 Stat. 579, 15 U.S.C. § 78p(a).

QUESTION PRESENTED.

May the beneficial owner of more than 10% of an issuer's stock, desiring to sell all of its stock of the issuer at a profit within six months of the purchase of such stock, insulate from Section 16(b) of the Securities Exchange Act of 1934 and retain for its own benefit the short-term profits on 9.96% of such stock by effecting its single predetermined plan of disposition through the technique of two sales, the first of which reduces the beneficial owner's holdings to 9.96%, and the second of which disposes of the balance?

STATEMENT OF THE CASE.

On June 16, 1967, pursuant to a tender offer for shares of Dodge Manufacturing Company ("Dodge"), Emerson Electric Company, respondent herein ("Emerson"), purchased 152,282 shares of Dodge stock at $63 per share (A. 15). These shares constituted 13.2% of the then outstanding Dodge common stock (A. 17). Prior thereto, Emerson had owned no shares of Dodge common stock (A. 15).

On or about June 1, 1967, Dodge entered into an agreement to merge Dodge into Reliance Electric Company,[2] petitioner herein ("Reliance") (A. 157-58). On June 17, 1967, Emerson told Dodge it intended to solicit proxies for the August 22, 1967 Dodge shareholders meeting in opposition to the merger (A. 103). Under date of June 26, 1967, Emerson's general counsel sent Emerson

---

[2] On March 3, 1969, The Reliance Electric and Engineering Company, an Ohio corporation, changed its name and its state of incorporation by merging into its wholly-owned subsidiary, organized for that purpose, Reliance Electric Company, a Delaware corporation. All of the business and assets of Reliance of Ohio, and all of its liabilities and obligations, became those of Reliance of Delaware by operation of law.

a letter discussing alternatives to the proxy contest with Reliance. This letter discussed "principally, how to dispose of, at a profit, the shares of Dodge stock which Emerson now owns," and outlined a plan of "defensive action against 16(b) possibilities" (A. 33-38).

At the Dodge shareholders meeting on August 22, 1967, the Dodge shareholders approved the merger of Dodge into Reliance (A. 65). Shortly thereafter, pursuant to counsel's plan, Emerson negotiated a sale by Emerson and purchase by Goldman, Sachs & Co. of 37,000 shares of Dodge common stock at $68 per share (A. 16). The agreement of sale was made on August 28, 1967; Emerson delivered the subject shares to Goldman, Sachs on August 29, and received payment on September 1 (A. 16). Emerson's remaining 115,282 shares constituted 9.96% of the then outstanding Dodge common stock (A. 17).

On August 29, 1967, Reliance, on behalf of Dodge, initiated discussions with Emerson with respect to the purchase of the remaining 115,282 shares of Dodge common stock (A. 16). On September 5, 1967, Emerson agreed to sell and Dodge agreed to buy the 115,282 shares at $69 per share; a purchase agreement effecting this sale was executed on September 11, and the closing thereunder took place on September 13, 1967 (A. 17). On September 29, 1967, Dodge merged into Reliance (A. 18).

On February 29, 1968, Emerson filed a petition for declaratory judgment in the United States District Court for the Eastern District of Missouri (the "District Court"), asking that the court determine and declare the liability, if any, of Emerson to Reliance for the amount of the profits realized by Emerson for the two sales of Dodge stock described above (A. 3). Jurisdiction of the District Court was based on Section 27 of the Securities Exchange

Act of 1934 (15 U.S.C. § 78aa), and upon diversity of citizenship and amount. In trial on the issue of liability alone, the District Court determined that Emerson is liable to Reliance for the net profits realized by it from the sales of all 152,282 shares of stock of Dodge, for the reasons set forth in its Memorandum Opinion filed September 18, 1969 (A. 157).

The United States Court of Appeals for the Eighth Circuit (the "Eighth Circuit") granted Emerson's petition for leave to take an interlocutory appeal under 28 U.S.C. § 1292(b) (A. 169). The Eighth Circuit accepted the findings of the District Court set forth below, but held that as a matter of law Section 16(b) does not apply to Emerson's profits on the second sale (A. 179-82).

The relevant and undisturbed findings of the District Court were (1) "Emerson's initial sale of 37,000 shares was motivated solely by its desire to reduce its holding to just under 10% immediately prior to disposing of the balance of its shares in an attempt to escape Section 16(b) liability on the short-swing profits it contemplated would be made on such remaining shares"; (2) ". . . that although the two sales of Dodge stock were technically separate transactions and the second sale was not 'legally' tied in any way to the first sale, the two sales were effected pursuant to a single pre-determined plan of disposition with the overall intent and purpose of avoiding Section 16(b) liability"; and (3) that ". . . the obvious substance of the transaction as to a whole is the disposition of its [Emerson's] more than 10% beneficial interest" (A. 163-64).

SUMMARY OF ARGUMENT.

The two-step sale procedure used by Emerson and approved by the Eighth Circuit is a technique by which a 10% beneficial owner can take short-term profits whenever the opportunity arises. As such, it is the kind of transaction which lends itself to abuse of the fiduciary duty which Section 16(b) imposes upon every insider subject to its regulation. As the two-step sale procedure is a planning technique readily adaptable to nearly every disposition of stock by a 10% beneficial owner, the integrity of Section 16(b) will be materially impaired if the decision below is allowed to stand.

The Eighth Circuit based its holding on its view that Section 16(b) sets forth "arbitrary standards enacted by Congress" which require extremely literal application. In so holding, it erred, for it failed to apply to Emerson's two-step sale procedure those judicially-approved standards of construction of Section 16(b) which require (i) that the facts of the transaction before the court should be analyzed with a view to discerning their substance, and their potential for abuse as a means of taking insider profits, and (ii) that the terms used in Section 16(b) should be defined broadly and remedially, and strictly against the insider, with a view to the consequences of the decision in furthering the statutory purpose.

Emerson's two dispositions of Dodge stock were separate under local law, but were interrelated parts of a single plan to dispose of all of Emerson's holdings in an attempt to avoid Section 16(b). The characterization of a transaction under local law does not conclude its characterization under Section 16(b). The two-step sale procedure, united in purpose and intent, should be treated as one "sale" under Section 16(b). Emerson thus will have been a 10% beneficial owner "at the time of" its sale of all its Dodge stock.

Section 16(b) is to be applied to the substance, rather than to the form, of the transactions in question. The District Court found that "the obvious substance" of Emerson's transaction was the disposition of its entire holdings of Dodge stock. Emerson should not be permitted to separate its integrated disposition of Dodge stock into two steps so as to escape a liability under Section 16(b) which would attach if the disposition had been accomplished in one step.

By purchasing 13.2% of the stock of Dodge, Emerson assumed fiduciary responsibilities toward Dodge. Emerson profited substantially from short-term trading in the stock of its *cestui que trust*. All such profits should inure to the issuer. To prevent a lowering of fiduciary standards, the decision of the Eighth Circuit as to Emerson's second sale should be reversed.

ARGUMENT.

I. THE TWO-STEP SALES TECHNIQUE IS A FORM OF STOCK DISPOSITION WHICH LENDS ITSELF TO THE SPECULATIVE ABUSE SECTION 16(b) WAS DESIGNED TO PREVENT.

As its preamble states, Section 16(b) was intended by Congress to prevent the unfair use of information by statutory insiders—directors, officers, and 10% beneficial owners—in trading in the issuer's securities. The "uncommon regulatory mechanism" by which Section 16(b) operates to achieve this legislative intent in "relatively automatic" fashion is to make recoverable by the issuer *any* profit by the insider from *any* purchase and sale within a six-month period. *Blau v. Lamb*, 363 F.2d 507, 515-16 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967). Within the statutory guidelines, Section 16(b) has been construed as broadly as possible to extend to every kind

of transaction in which inside information could possibly have been used by an insider to make short-term profits.

While Emerson was a statutory insider, the owner of 13.2% of Dodge shares, it determined to dispose of its entire interest in Dodge. In an attempt to "avoid the consequences" of Section 16(b) (A. 164) and retain the major portion of its substantial short-term profits in Dodge stock, Emerson sold just enough shares to bring its holdings under 10%[3], and promptly thereafter sold the balance of its holdings in a separately negotiated sale to a different buyer, Dodge. In less than three months Emerson, a statutory insider, had made over $900,000, less allowable expenses, by trading in Dodge stock. The Eighth Circuit, reversing the District Court, decided below that Emerson's attempt to "avoid the consequences" of Section 16(b) was successful, and that Emerson may retain its profits on the second sale.[4]

Prior to the decision of the Eighth Circuit in the instant case, no federal court had ever approved a technique by which a statutory insider could so shape his transactions in his issuer's shares as to insulate from Section

---

[3] Emerson's counsel had recommended, as "the initial defensive step," the sale of 37,100 shares of Dodge stock (A. 36). An increase in the number of Dodge shares outstanding between June 16 and August 22 permitted Emerson to follow the plan by selling only 37,000 shares, reducing its holding to 9.96% (A. 163).

[4] The Eighth Circuit also decided, affirming the District Court Court on this issue, that the purchase by which Emerson became a 10% beneficial owner is to be counted in determining liability under Section 16(b). As Emerson did not cross-petition for certiorari, that portion of the decree below which was decided adversely to Emerson is not before this Court. *Alaska Industrial Bd. v. Chugach Electric Ass'n*, 356 U.S. 320 (1958); *LeTulle v. Scofield*, 308 U.S. 415 (1940). As the legal issue involved in Emerson's purchase was not raised as a Question Presented in the Petition for Writ of Certiorari, it is not to be briefed or argued by the parties. Supreme Court Rules 40(1)(d)(2), 40(3).

16(b) a substantial portion of profits realized by him from stock purchases and sales within a six-month period. Now, for the first time in the history of decisions under Section 16(b), short-term profits may be made, and kept, by an insider who follows what the District Court called the "two-step sale procedure" (A. 164) used by Emerson and approved by the Eighth Circuit.

In the recent decision of *Abrams v. Occidental Petroleum Corp.*, 323 F. Supp. 570 (S.D.N.Y. 1970), Occidental was held liable under Section 16(b) for about $17,700,000 of short-term profits in the purchase and sale of shares of Kern County Land Company. If Occidental had followed the two-step sale procedure used by Emerson, and had entered into two option agreements with different optionees on different days, pursuant to its plan of disposition, Occidental would have insulated from recovery, by means which the Eighth Circuit permits, more than $8,600,000 of its short-term profits in Kern County stock. If the Eighth Circuit's decision is affirmed, well-advised insiders will not repeat the tactical error made by Occidental, and the two-step sale technique will become the "standard operating procedure" in every short-term disposition of stock by a 10% beneficial owner.

The initial inquiry in applying Section 16(b) is always whether the transaction in question "could possibly tend to accomplish the practices Section 16(b) was designed to prevent." *Blau v. Lamb, supra*, 363 F.2d at 519; *cf. Newmark v. RKO General, Inc.*, 425 F.2d 348, 351 (2d Cir.), *cert. denied*, 400 U.S. 854 (1970). If Emerson had possessed inside information just prior to August 28, 1967, when it owned 13.2% of Dodge stock, could both the first sale *and* the second sale have been apt vehicles for taking short-term profits on that information? Clearly so. A sale for cash is always an apt vehicle for taking

profits; and inside information may give an insider an unfair advantage which lasts for several weeks.

If the Eighth Circuit's decision is affirmed, Emerson's two-step sale procedure can be used by any 10% beneficial owner at any time to make and keep short-term profits based on actual use of inside information.[5] The technique can be illustrated as follows: If Jones, the owner of 15% of the stock of X Corporation, learns by virtue of his position as an insider that at a directors' meeting two weeks hence the quarterly dividend will be reduced, Jones can thereupon, pursuant to a plan, sell 5.1% of his stock, wait a few days, and then sell the remaining 9.9%. After the directors have met and lowered the dividend, and the market has responded to the news, Jones can repurchase his 15%. Under the rule set forth by the Eighth Circuit in the decision below, Jones will be liable for only a little over one-third of his short-term profits, the profit on the sale and repurchase of 5.1% of the stock, to X Corporation, and will pocket his short-term profits on the remaining 9.9% free from Section 16(b).

Section 16(b) has been applied to a variety of transactions which, though found to be capable of insider abuse, could not have been availed of readily as a means of Section 16(b) avoidance. For example, the second closing under an agreement to sell a business entered into three years before does not suggest itself as a practical

---

[5] The fact that there may be a cause of action against such an insider using the two-step sale procedure under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder does not provide an adequate substitute for a deficiency in Section 16(b), for the plaintiff in a Rule 10b-5 suit has the burden of showing actual abuse of inside information. Section 16(b), with its automatic "rule-of-thumb" operation, was enacted precisely to eliminate this often very difficult burden of proof. *Smolowe v. Delendo Corp.*, 136 F.2d 231, 235 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943).

planning device for avoiding Section 16(b) liability, *Booth v. Varian Associates*, 334 F.2d 1 (1st Cir. 1964), *cert. denied*, 379 U.S. 961 (1965). Neither does the sale of one's entire stock holdings pursuant to an anti-trust consent decree, *Western Auto Supply Co. v. Gamble-Skogmo, Inc.*, 348 F.2d 736 (8th Cir. 1965), *cert. denied*, 382 U.S. 987 (1966). Yet in both cases Section 16(b) liability was imposed because insider abuse was possible. In contrast, the two-step sale procedure, if it stands, will be a technique readily applicable in nearly every 10% beneficial owner situation; *a fortiori*, Section 16(b) liability should be imposed on both of Emerson's sales.

In the entire Securities Exchange Act of 1934, Section 16(b) has been perhaps the most "cordially disliked" provision, II Loss, *Securities Regulation* 1087 (1961); yet it "has undoubtedly had a substantial deterrent effect." *Id.* at 1043. A major reason for the great deterrent effect of Section 16(b) has been the well-founded belief of corporate insiders that no "technique" or method of framing their transactions will permit them to retain profits on sales of shares acquired within six months. The decision below establishes for the first time a significant exception to this rule, because it approves a technique, Emerson's two-step sale procedure, whereby a 10% beneficial owner can readily take short-term insider profits at will.[6] The

---

[6] The Eighth Circuit based its holding in part upon its statement that "there is no reason why a person may not conduct his business in such a way as to *intentionally minimize or eliminate his loss of profits* under Section 16(b) by any means permitted by law." (A. 180; Emphasis added.) First, the statement is question-begging: "It begs the question to say that a taxpayer has the legal right to decrease, by means which the law permits, the amount of what would otherwise be his taxes. The question here is whether the statute does permit a taxpayer to reduce his taxes by the means the taxpayer here employed." *Loewi v.*

(*Continued on following page*)

effectiveness of Section 16(b) as a standard of conduct for corporate insiders will be materially impaired if this Court permits the decision below to stand. The decision of the Eighth Circuit on Emerson's second sale should be reversed.

II. SECTION 16(b)'s "ARBITRARY STANDARDS" DO NOT PRECLUDE ANALYSIS OF THE POTENTIAL FOR ABUSE IN THE FACTUAL SITUATION AND BROAD AND REMEDIAL CONSTRUCTION OF THE TERMS OF THE STATUTE.

The last sentence of Section 16(b) contains the following exemptive provision:

> This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved . . . .

The Eighth Circuit held that Emerson's second sale "literally" fell within this exemption (A. 181) and felt itself unable to construe the exemption otherwise. The Eighth Circuit based its concededly literal construction of Section 16(b) on its view that the section contains "arbitrary standards enacted by Congress" and so requires extremely literal interpretation. The Court stated that (A. 181):

> The standards set forth in Sections 16(a) and 16(b) are arbitrary both in the selection of time, 6 months, and the selection of amount, more than 10 percentum. A security transaction either falls within or without

---

(*Continued from preceding page*)

Ryan, 229 F.2d 627, 630 (2d Cir. 1956) (Frank, J., dissenting). Second, and more important, the favorable attitude toward intentional preservation by an insider of his short-term profits which the Eighth Circuit here expressed stands in startling contrast to the attitude expressed by federal courts in nearly every significant prior decision construing Section 16(b).

> the scope of Section 16(b) depending on whether these arbitrary standards are met. (Footnote omitted.)

Based on this analysis, the Eighth Circuit did not consider whether Emerson's two-step sale procedure contained a potential for abuse of Section 16(b) which should not be permitted, or whether a remedial construction of Section 16(b) in light of the legislative purpose did not require more than an arbitrary and literal application of its terms. Having so handicapped itself, the Eighth Circuit was unable to correct the very abuse it recognized when it stated (A. 179): "In *less than three months* from its stock purchase Emerson apparently *had made substantial short-term profits* related to its stock acquisition activities in its efforts to gain stock control of Dodge." (Footnote omitted; emphasis added.)

"Arbitrary" standards have not prevented other courts from applying Section 16(b) to the substance of transactions before them, even where this has required extensive factual analysis of the circumstances of the transaction and of the intent of the insider as it bears thereon. "Arbitrary" standards have not deterred other courts from giving effect to the "broadly remedial" and "thoroughgoing" construction required under Section 16(b) by "strictly construing the statute against the insider in order to effectuate its wholesome purpose." *Western Auto Supply Co. v. Gamble-Skogmo, Inc.*, 348 F.2d 736, 743 (8th Cir. 1965), *cert. denied*, 382 U.S. 987 (1966). Factual analysis and remedial construction in cases involving the definitions of "purchase" and "sale" under Section 16(b) are familiar (see Part III below); moreover, the same responsibility to effectuate the statutory purpose has been exercised with respect to the very statutory standards, *i.e.*, insider status and the six-month

period, which the Eighth Circuit characterized as arbitrary.

Section 16(b) may not be extended to impose liability on those neither officers, directors nor 10% beneficial owners, *Blau v. Lehman*, 368 U. S. 403 (1962). But in *Feder v. Martin Marietta Corp.*, 406 F.2d 260 (2d Cir. 1969), *cert. denied*, 396 U.S. 1036 (1970), the court found, only after extensive factual analysis, that Martin Marietta was a "director" of Sperry Rand for purposes of Section 16(b) through its deputy, George Bunker, who sat on the Sperry Rand board. Similarly, in *Chemical Fund, Inc. v. Xerox Corp.*, 377 F.2d 107 (2d Cir. 1967), the court construed the "10% beneficial owner" standard in the light of the statutory purpose of Section 16(b) as not applicable to the holder of more than 10% of a class of convertible debentures, even though the term literally applied. And in *Colby v. Klune*, 178 F.2d 872 (2d Cir. 1949), the court reversed a grant of summary judgment and remanded for full trial on the facts the question whether a corporate employee not holding the title of officer had such access to confidential corporate information that he should be deemed to be an "officer" for purposes of Section 16(b). The potential for unfair use of inside information, which in all these cases was the deciding factor, was ignored by the Eighth Circuit in the decision below.

"Less than six months" is an equally "arbitrary" standard, but "careful scrutiny" is required in any situation in which, as here, a statutory insider has shortened his period of investment risk to less than six months. In *Bershad v. McDonough*, 428 F.2d 693, 697 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971), the court was confronted with a "sale" which took place six months and one week after the purchase, and held that the grant of an option to purchase within the six-month period was a "sale" for pur-

poses of Section 16(b). In *Booth v. Varian Associates*, 334 F.2d 1, 4 (1st Cir. 1964), *cert. denied*, 379 U.S. 961 (1965), the question whether the statutory six-month period began with the signing of a contract to deliver shares or with their later delivery was resolved by analysis of the transaction to reach the result "most consonant with the statutory purpose." Here, where less than three months separated Emerson's only purchase from its final profitable sale, similar close analysis and remedial construction is required to prevent abuse.

Analysis of a transaction in the light of the purpose of Section 16(b) may require examination of the insider's intent. It is true that the intention of an insider to profit by unfair use of inside information, or to trade on a short swing, is irrelevant under Section 16(b). *Feder v. Martin Marietta Corp., supra*, 406 F.2d at 262. But what the insider intended his act or transaction to be is often an important factor in analyzing his act or transaction under Section 16(b). In *Martin Marietta*, the fact that the management of Sperry Rand and Martin Marietta intended that Bunker should act as Martin's deputy on the Sperry board was crucially relevant to the determination that Bunker was Martin's deputy. 406 F.2d at 265. As Judge Medina explained in *Truncale v. Blumberg*, 80 F. Supp. 387, 391-92 (S.D.N.Y. 1948), discussing the difference under Section 16(b) between a gift and a sale:

> It is argued that the statute was designed to operate irrespective of any intention on the part of the insider.
>
> . . . .
>
> But references in the cases to the operation of the statute irrespective of intention are plainly to the subject of intention to benefit by the use of inside information, see, e.g., Smolowe v. Delendo Corporation, 2 Cir., 1943, 136 F.2d 231, 235, 236, 148 A.L.R.

> 300, and the whole history of this legislation shows that the statutory scheme was deliberately designed to discourage short term speculation by insiders by eliminating the necessity of proof that there was an intentional and willful wrong by a profit-seeking fiduciary, unmindful of his duty. Hence no showing of an actual unfair use of inside information is required. *The intention now under discussion is of a different sort.* Whether a transaction is real or merely a device or artifice to avoid the impact of the statute must depend upon intention. By the application of familiar principles *the transaction falls into one category or another depending upon the intention of the parties.* (Emphasis added.)

Where, as here, the District Court found that Emerson intended "to dispose of its entire stock holdings pursuant to a plan" (A. 162), and concluded from this that "the two sales were in fact interrelated parts of a single plan" (A. 164), the reviewing court cannot dismiss the application of Section 16(b) to the entire plan by reference to "arbitrary standards."

The duty of a court when applying Section 16(b) cannot therefore be discharged by literal application of the statutory wording and a reference to the "arbitrary standards enacted by Congress." Particularly in a case in which a technique permitting obvious frustration of the statutory purpose is presented, like Emerson's two-step sale procedure, the substance of the transaction must be measured against the purpose of the statute taken as a whole, and the consequences of approval of a readily applicable technique of minimizing short-term profit recoveries must be taken into account. As Judge (now Mr. Chief Justice) Burger expressed it in *Adler v. Klawans,* 267 F.2d 840, 844 (2d Cir. 1959):

> In addition to the intent and purpose of the legislation which we must glean from the statute as a whole

> rather than from isolated parts, we must consider the results which would flow from each of the two interpretations contended for. If we find one interpretation tends to carry out and the other to defeat the purposes of the statute, the resolution of the issue becomes simple.

Within the statutory boundaries of Section 16(b) there have been and there remain many questions requiring statutory construction; the application of Section 16(b) to Emerson's two-step sale procedure is one such. The applicable rule of construction was stated in *Adler v. Klawans, id.* at 846-47, as follows:

> These prior holdings do not answer the problem presented here, but they do show a pattern of this court's view that the purpose of the statute is remedial, rather than penal, and that it must be strictly construed in favor of the corporation and against any person who makes profit dealing in the corporation stock. Of course, the statute cannot be extended beyond the limits of its language, but as we have pointed out above, the language, given a rational interpretation is broad enough to cover appellant's transaction in this instance.

As will be shown immediately below, a rational interpretation (indeed, the only acceptable interpretation) of Section 16(b)'s exemptive clause shows that it is inapplicable to the second sale of Emerson's two-step sale procedure. It follows that the decision of the Eighth Circuit as to Emerson's second sale should be reversed.

III. THE EXEMPTIVE PROVISION IN SECTION 16(b) DOES NOT EXEMPT THE SECOND OF TWO SALES EFFECTED PURSUANT TO A SINGLE PRE-DETERMINED PLAN OF DISPOSITION.

The Eighth Circuit held that Emerson's second sale fell literally within the language of Section 16(b) which provides that: "This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale . . . ." We submit that the Eighth Circuit erred on two alternative grounds: first, it treated as two sales what should have been treated as one "sale" for purposes of Section 16(b), ignoring in its analysis the very findings of fact of the District Court which lead compellingly to the conclusion that one Section 16(b) "sale" took place; and second, it refused to approve the application of step transaction analysis and substance over form principles by which the District Court found in substance a single integrated disposition of stock by a 10% beneficial owner. More important than the technical analysis set forth in this Part III, of course, is the obvious fact that whatever the exemptive provision was intended to accomplish,[7] it could not have been intended by Congress to allow to 10% beneficial owners a readily available technique for taking the very short-term profits which the body of Section 16(b) so clearly prohibits. The technical analysis leads to the same conclusion.

---

[7] There is apparently no legislative history bearing on the exemptive clause, as it was added to the Act in late and closed drafting sessions. In an early article, Seligman, "Problems Under the Securities Exchange Act," 21 *Va. L. Rev.* 1, 20 (1934), Mr. Seligman hypothesized that "the intention of the language was to exclude the second sale in a case where 10% is purchased, 5% sold within three months and the remaining 5% a month later." Mr. Seligman did not opine on two sales within 8 days pursuant to a single pre-determined plan of disposition, a far different case.

A. Emerson's Two Sales Are To Be Treated as One "Sale" Under Section 16(b).

The thoroughgoing and remedial purpose of Section 16(b) has most often been furthered in judicial decisions by giving a broad interpretation to the terms "purchase" and "sale." The rule of construction was succinctly stated by Judge (now Mr. Justice) Stewart in *Ferraiolo v. Newman*, 259 F.2d 342, 345 (6th Cir. 1958), *cert. denied*, 359 U.S. 927 (1959): "Every transaction which can reasonably be defined as a purchase [or a sale] will be so defined, if the transaction is of a kind which can possibly lend itself to the speculation encompassed by Section 16(b)." The two-step sale procedure is a transaction of this kind.

The Eighth Circuit believed that the District Court found "as a fact that Emerson made two separate sales not legally tied together in any way . . ." (A. 180), and based its holding, as a matter of law, upon that "finding of fact." The District Court found no such thing, as its Memorandum Opinion makes plain. When the District Court stated that "the second sale was not 'legally' tied in any way to the first sale" (A. 163), it used quotation marks to set off the word "legally," in a clear reference to the letter of Emerson's counsel which set forth the plan used by Emerson to "avoid the consequences" of Section 16(b). When the District Court found that the two sales were "technically separate transactions," it clearly meant that the sales were separate sales as a matter of contract law; but when analyzed under Section 16(b), the two technically separate transactions were found to be united as "interrelated parts of a single plan" (A. 164). Far from finding the sales not "legally" related, the District Court held that "the obvious substance" of Emerson's transaction was the disposition of Emerson's more than 10% interest (*Ibid.*).

In finding that Emerson's two sales should be treated as in substance one disposition or "sale" under Section 16(b), the District Court did not hold, nor has Reliance ever contended, that Emerson's first sale to Goldman, Sachs was a sham transaction; it was concededly a bona fide effective disposition of 37,000 shares of Dodge stock, under a separate contract, independent of Emerson's second sale to Dodge in all respects *except in respect of Section 16(b)*. As Emerson succinctly stated below (A. 168; emphasis added):

> The two sales were negotiated separately, at different times, by different representatives of Emerson, for different prices, to different purchasers having no connection or relationship with each other and, *except for the fact that they were made pursuant to Emerson's decision to dispose of its entire holdings of Dodge stock upon the most favorable terms,* were separate and distinct from each other in every respect.

The characterization of a transaction for local law purposes, however, does not conclude the characterization of the same transaction under Section 16(b). "The phrase 'any purchase and sale' in Section 16(b) is therefore not to be limited or defined solely in terms of commercial law of sales and notions of contractual rights and duties." *Bershad v. McDonough,* 428 F.2d 693, 697 (7th Cir. 1970), *cert. denied,* 400 U.S. 992 (1971). An exchange of shares of the acquired corporation for those of an acquiring corporation in a statutory merger is not a sale in any commercial or contractual meaning of the words; yet it was held a "sale" under Section 16(b) because unfair use of inside information was possible. *Newmark v. RKO General, Inc.,* 425 F.2d 348 (2d Cir.), *cert. denied,* 400 U.S. 854 (1970). The grant of an option to purchase shares is not a sale of those shares under corporate or stock trans-

fer law; yet, because insider abuse was possible, the grant was held a "sale" under Section 16(b). *Bershad v. McDonough, supra.* Where unfair use of inside information was possible, a voluntary conversion of convertible preferred stock into common stock was held a "purchase" of the common stock. *Park & Tilford v. Schulte,* 160 F.2d 984 (2d Cir.) *cert. denied,* 332 U.S. 761 (1947).

As shown above in Part II, what the insider intended his transaction to be is a relevant factor in determining how Section 16(b) applies to that transaction. Here Emerson intended "the disposition of its more than 10% beneficial interest" (A. 164) pursuant to a single plan. It carried out this disposition of Dodge stock by means of its two-step sale procedure. As shown in Part I above, the two-step sale procedure is capable of the abuse Section 16(b) was designed to prevent. Accordingly, the two-step sale procedure used by Emerson should be treated as one "sale" as the term is used in Section 16(b), and Emerson will have been a 10% beneficial owner of Dodge "at the time of" such sale.

Treating separate acts or contracts of disposition as one "sale" under Section 16(b) is not novel or unprecedented. In *Abrams v. Occidental Petroleum Corp.,* 323 F. Supp. 570, 574, 579 (S.D.N.Y. 1970), the findings of fact clearly indicate that Occidental purchased shares of Kern County Land Company at several different times from many different sellers between May 8 and June 8, 1967, pursuant to its tender offer; in its conclusions of law, the court held that: "The tender offer constituted a single act of Occidental, whereby the company became a beneficial owner of more than 10 percent of Old Kern's capital stock." Indeed, when Emerson purchased 152,282 Dodge shares on June 16, 1967, in its tender offer, each seller of Dodge stock to Emerson entered into a separate contract with Emerson by executing a letter of transmittal (A. 25);

yet Emerson has not contended that it made two or three thousand separate purchases rather than one "purchase" under Section 16(b). The view that several contractual transactions can constitute one "sale" under Section 16(b) was assumed without examination in *Stella v. Graham-Paige Motors Corp.*, 132 F. Supp. 100, 105 (S.D.N.Y. 1955), *affirmed in part*, 232 F.2d 299 (2d Cir.), *cert. denied*, 352 U.S. 831 (1956), where the trial judge stated:

> I pass to the question of the date of the sale. *The sale* of the 155,000 shares of Kaiser-Frazer stock *took place in three transactions*: a block of 10,000 shares was sold to one Frederick Lewisohn, a block of 45,000 shares was sold to investors through Otis & Company and a block of 100,000 shares was sold to Permanente Metals Corporation, a corporation substantially owned and controlled by Henry J. Kaiser. (Emphasis added.)

The District Court below applied Section 16(b) to Emerson's disposition as to a single transaction. The District Court recognized that any other result would "subvert the purposes of Section 16(b) and produce a result plainly at variance with its manifest policy" (A. 164). A proper ground for affirmance of the District Court and reversal of the Eighth Circuit, well-supported in prior decisions under Section 16(b), is the definition of Emerson's two-step sale procedure as a single "sale" as that term is defined in Section 16(b).

B. Section 16(b) Should Apply to Both of Emerson's Sales Transactions Under Substance Over Form Principles and the Step Transaction Doctrine.

The definition of "purchase" and "sale" under Section 16(b) and the application of those terms to Emerson's two-step sales technique is a particular application of general rules of statutory construction frequently referred to as the "substance over form" and the "step transaction" doctrines. The Eighth Circuit erred not only by failing to apply the principles of construction of the terms "purchase" and "sale" under Section 16(b), as discussed above, but also by failing to consider those broader principles, applied by the District Court, which provide an independent ground for concluding that Section 16(b) applies to Emerson's second sale.

It is a principle of general applicability that courts apply the law to the substance rather than to the form of transactions. This is what the District Court did below. Ten days after Emerson became a 10% beneficial owner of Dodge, Emerson's counsel wrote a letter to Emerson's Chairman of the Board which considered "principally, how to dispose of, at a profit, the shares of Dodge stock which Emerson now owns" (A. 33). The letter advised that "Emerson should proceed on the assumption that 16(b) does apply and should seek to avoid its consequences," and recommended as an "initial defensive step" that Emerson give away or sell 37,100 shares of Dodge stock, whereupon it could sell the balance "free of any 16(b) risk . . ." (A. 36). Emerson followed the plan so precisely that its first sale reduced its holdings to exactly 9.96% of the then outstanding shares of Dodge; and then Emerson promptly sold the balance. The District Court found that "the obvious substance" of Emerson's transaction was the disposition of its entire more than 10%

interest in Dodge, and, "looking through form to discern substance," applied Section 16(b) to the substantive single transaction it found (A. 174).

The Eighth Circuit seized upon the District Court's finding that the two sales were technically separate transactions, and did not otherwise deal with what the District Court found to be the substance of Emerson's two-step sale procedure, except to analogize Emerson's conduct to "tax avoidance conduct which is permissible" (A. 180). The Eighth Circuit cited only *Gregory v. Helvering*, 293 U.S. 465 (1935), in support of its view, thus curiously relying on the landmark federal income tax case applying the doctrine of substance over form. In *Gregory*, a transaction which concededly met all the literal statutory requirements for freedom from tax, as Emerson had met what it believed to be the literal statutory requirements for freedom from Section 16(b), was held not to be tax-free because the substance of the transaction was contrary to the intent of Congress as expressed in the statute as a whole. While *Gregory v. Helvering* may be read narrowly, as applying only to sham transactions having no non-tax reality, it has not in fact been so construed. Bittker & Eustice, *Federal Income Taxation of Corporations and Shareholders* 555, 605, 629 (2d Ed. 1966). At the very least, it has application to transactions which are not pure sham, but are devices to avoid a statutory liability; and if Emerson's first sale was not a sham, since it did constitute a bona fide arm's length disposition of Dodge stock, it was certainly and principally a device for facilitating later short-term profit-taking. The District Court expressly found that (A. 173): "Emerson's initial sale of 37,000 shares *was motivated solely* by its desire to reduce its holding to just under 10% immediately prior to disposing of the balance of its shares in an attempt to escape Section

16(b) liability on the short-swing profits it contemplated would be made upon such remaining shares." (Emphasis added.) In applying a statute which is to be broadly and remedially construed against the insider, intentional avoidance of statutory liability cannot be permitted.

An application of substance over form principles which does not require a finding that a transaction involved sham or subterfuge is the step transaction doctrine. Under this rule, a person will not be allowed to separate an integrated transaction into two distinct steps, each of which, when taken separately, is permissible, to escape the legal consequences which would attach to the transaction if done in one step. The District Court applied this rule to Emerson's two-step sale procedure (A. 174); the Eighth Circuit, erroneously, we submit, did not.

The step transaction doctrine is well established in the field of Federal income taxation, where the term "step transaction" refers to a group of closely related rules, varying formulations of which are applicable in various substantive areas of tax law. A careful analysis of the doctrine is found in *King Enterprises, Inc. v. United States*, 418 F.2d 511 (Ct. Cl. 1969). There it is pointed out that while one formulation of the step transaction doctrine requires that the steps be so interdependent that the legal relations created by the first step would be fruitless without completion of the series, *cf. American Bantam Car Co.*, 11 T.C. 397 (1948), *affirmed*, 177 F.2d 513 (3d Cir. 1949), *cert. denied*, 339 U.S. 920 (1950), there is another and broader formulation, where steps not fruitless standing alone will be treated as a single transaction if it appears that they were really component parts of a larger transaction intended from the outset to reach the ultimate result, *cf. Anheuser-Busch, Inc. v. Helvering*, 40 B.T.A. 1100 (1939), *affirmed*, 115 F.2d 662 (8th Cir.

1940), *cert. denied*, 312 U.S. 699 (1941). In *King Enterprises*, the broader "end result" test was applied; it was pointed out that the vitality of the doctrine depends upon its broad construction, and that the reference to "binding commitment" in *Commissioner v. Gordon*, 391 U.S. 83 (1968), cannot have been intended to permit avoidance of the step transaction rule. See also *United States v. General Geophysical Co.*, 296 F.2d 86 (5th Cir.), *rehearing denied*, 62-1 U.S.T.C. ¶ 9115 (5th Cir. 1961), *cert. denied*, 369 U.S. 849 (1962), in which the court held that two transactions concededly not connected by a "binding commitment" or independently "fruitless" should be treated as one for tax purposes, and on rehearing pointed out in great detail how application of the step transaction doctrine was perfectly consistent with treatment of the two transactions as fully valid and independently effective for all state law purposes.

The step transaction doctrine in its broadest form is well established in Federal securities law. In *SEC v. Micro-Moisture Controls, Inc.*, 148 F. Supp. 558, 562 (S.D.N.Y. 1957), *affirmed sub nom. SEC v. Culpepper*, 270 F.2d 241 (2d Cir. 1959), the court held that the "no sale" exemption provided in Rule 133 was inapplicable to the exchange of Converters assets for Micro-Moisture stock, even though the Rule had been literally complied with, because the exchange "was but a step in the major activity of selling the stock." See also *Great Sweet Grass Oils Ltd.*, 37 S.E.C. Reports 683 (1957), *affirmed*, 256 F.2d 893 (D.C. Cir. 1958). Similarly, in *The Crowell-Collier Publishing Co.*, Securities Act Release No. 3825 (1957), 1957-61 CCH Fed. Sec. L. Rep. ¶ 76,539 at p. 80,131, the Securities and Exchange Commission stated:

> Through these purported private offerings of debentures, options and warrants the company has accomplished and continues to accomplish by indirection that which it concluded early in 1955 could not be done directly: namely, obtaining substantial additional capital from the sale to the public of equity securities.
>
> It has been and is the Commission's position that an issuer or an underwriter *may not separate parts of a series of related transactions* comprising an issue of securities and thereby seek to establish that a particular part is a private transaction if the whole involves a public offering of the securities. (Emphasis added.)

Separating "parts of a series of related transactions" is precisely what Emerson did. The District Court below found as a fact that Emerson's two sales transactions were "related parts of a single plan devised by Emerson to dispose of all its Dodge stock in an attempt to 'avoid the consequences' of Section 16(b)" (A. 164). The Eighth Circuit accepted this finding (A. 180). The District Court applied the step transaction rule, holding that Emerson could not "excise Section 16(b) liability or 'avoid its consequences' by utilizing a series of related transactions, some of which considered separately might be exempt, when the obvious substance of the transaction as to a whole is the disposition of its more than 10% beneficial interest" (A. 164). The Eighth Circuit refused to apply the step transaction doctrine, thus creating a significant exception to the theretofore thoroughgoing and remedial scope of Section 16(b). If the step transaction doctrine is applicable under Federal income tax law and under the Securities Act of 1933, it should *a fortiori* be applicable under the remedial provisions of Section 16(b). We submit that the Eighth Circuit erred.

IV. SECTION 16(b) SHOULD BE CONSTRUED AS BROADLY AS POSSIBLE TO MAINTAIN FIDUCIARY STANDARDS.

When it decided to purchase 152,282 shares of Dodge stock from Dodge shareholders on June 16, 1967, Emerson elected to become a "statutory fiduciary" of Dodge. *Western Auto Supply Co. v. Gamble-Skogmo, Inc.*, 348 F.2d 736, 742 (8th Cir. 1965), *cert. denied*, 382 U.S. 987 (1966). As Judge Learned Hand stated in *Gratz v. Claughton*, 187 F.2d 46, 49 (2d Cir.), *cert. denied*, 341 U.S. 920 (1951), "Section 16(b) in effect made 'beneficial owners' fiduciaries as directors and officers were anyway." As a statutory fiduciary of Dodge, Emerson reaped substantial profits on the sale of those Dodge shares in less than three months. In its review of the decision of the Eighth Circuit, this Court will set forth standards of conduct which will guide other statutory fiduciaries under Section 16(b).

The classic statement of the standard of fiduciary conduct, repeatedly held applicable to statutory fiduciaries under Section 16(b) (*Smolowe v. Delendo Corp.*, 136 F.2d 231, 239 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943); *Blau v. Lehman*, 368 U.S. 403, 416-20 (1962) (Mr. Justice Douglas, dissenting); *Volk v. Zlotoff*, 285 F. Supp. 650, 656 (S.D.N.Y. 1968)), is that of Chief Judge Cardozo in *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545, 546 (1928):

> Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising

> rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. *Wendt v. Fischer,* 243 N.Y. 439, 444, 154 N.E. 303. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.

By its two-step sale procedure, Emerson made and kept substantial short-swing profits. The ultimate question presented here is whether Emerson is entitled to retain those profits. In the first case to arise in the federal courts construing Section 16(b), *Smolowe v. Delendo Corp., supra,* 136 F.2d at 239, the Second Circuit Court of Appeals determined that:

> . . . [T]he statute was intended to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or stockholder and the faithful performance of his duty.

The decision of the Eighth Circuit below permitted Emerson to retain the major portion of its short-swing profits, and approves a technique whereby other statutory fiduciaries can make and keep profits by careful arrangement of the form of their transactions. We submit that, to maintain well-established standards of fiduciary conduct under Section 16(b), the decision of the Eighth Circuit on Emerson's second sale must be reversed.

CONCLUSION.

The Court should reverse the judgment of the Eighth Circuit Court of Appeals on Emerson's second sale, and should affirm the judgment of the District Court and remand the cause for a determination of the amount of profits involved.

Respectfully submitted,

THOMAS P. MULLIGAN,
PATRICK J. AMER,
1750 Union Commerce Building,
Cleveland, Ohio 44115,

STEPHEN J. BURNS,
24701 Euclid Avenue,
Cleveland, Ohio 44117,

KENNETH S. TEASDALE,
611 Olive Street,
St. Louis, Missouri 63101,
Counsel for Petitioner.

Of Counsel:

JONES, DAY, COCKLEY & REAVIS,
ARMSTRONG, TEASDALE, KRAMER & VAUGHAN.

SUPREME COURT, U. S.

No. 70-79

Supreme Court, U.S.
FILED
AUG 5 1971
E. ROBERT SEAVER, CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1971

RELIANCE ELECTRIC COMPANY, PETITIONER

v.

EMERSON ELECTRIC COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

ERWIN N. GRISWOLD,
Solicitor General,
SAMUEL HUNTINGTON,
Assistant to the Solicitor General,
Department of Justice,
Washington, D.C. 20530.

PHILIP A. LOOMIS, JR.,
General Counsel,
WALTER P. NORTH,
Associate General Counsel,
JACOB H. STILLMAN,
Assistant General Counsel,
FREDERIC T. SPINDEL,
Attorney,
Securities and Exchange Commission,
Washington, D.C. 20549.

INDEX

	Page
Opinions Below	1
Jurisdiction	1
Question Presented	2
Statute Involved	2
Statement	3
The Interest of The Securities and Exchange Commission	8
Introduction and Summary	9
Argument:	
A Person Is Liable Under Section 16(b) Of The Securities Exchange Act of 1934 For Profits Realized By Him From A Purchase Followed Within Six Months By Sales Of A Corporation's Stock, Where Such Person Becomes A More Than 10 Percent Beneficial Owner Of The Corporation's Stock By Virtue Of The Purchase And Is A More Than 10 Percent Beneficial Owner At Any Time During The Period In Which The Sale Transactions Occur	14
A. Effectuation of Section 16(b)'s prophylactic purposes requires the statute's application to all of Emerson's transactions in Dodge stock	14
1. Congress intended Section 16(b) broadly to eliminate profits made by insiders on transactions within a six-month period	14
2. Section 16(b), like other remedial legislation, has been broadly interpreted in order to effectuate the congressional intent	18

440-192—71

Argument—Continued Page

3. The purchase by which one becomes a 10 percent beneficial owner, followed within six months by two sales, the second of which is made at a time when the seller no longer is a 10 percent beneficial owner, is a series of transactions capable of the insider abuses Section 16(b) was designed to prevent 22

B. Neither the purpose nor the language of the exemptive provision in Section 16(b) warrants excluding from the statute's operation any of Emerson's transactions in Dodge stock 28

1. The exemptive provision was not intended to preclude liability for profits made on transactions within the six-month period by a 10 percent beneficial owner who acquires such status by a voluntary purchase 29

2. The language in the exemptive provision may properly be construed as not excluding from Section 16(b)'s coverage any sale transactions effected within six months after a purchase by which a person becomes a 10 percent beneficial owner where such person is a 10 percent beneficial owner at any time during the period in which the sale transactions occur 34

Conclusion 36

CITATIONS

Cases:

Abrams v. *Occidental Petroleum Corp.*, 323 F. Supp. 570 21

Adler v. *Klawans*, 267 F. 2d 840 ..... 19, 22, 23, 25, 26, 29, 30, 36

Arkansas Louisiana Gas Co. v. *W. R. Stephens Investment Co.*, 141 F. Supp. 841 21

Bershad v. *McDonough*, 428 F. 2d 693, certiorari denied, 400 U.S. 992 ..... 19, 21, 22

Cases—Continued

	Page
Blau v. *Allen*, 163 F. Supp. 702	22
Blau v. *Hodgkinson*, 100 F. Supp. 361	19
Blau v. *Lehman*, 368 U.S. 403, affirming 286 F. 2d 786	8, 18, 19
Blau v. *Mission Corp.*, 212 F. 2d 77, certiorari denied, 347 U.S. 1016	19
Capital Funds, Inc. v. *Securities and Exchange Commission*, 348 F. 2d 582	20
Commissioner of Internal Revenue v. *Estate of Sternberger*, 348 U.S. 187	20
Feder v. *Martin Marietta Corp.*, 406 F. 2d 260, certiorari denied, 396 U.S. 1036	19, 22, 23, 26, 29
Ferraiolo v. *Newman*, 259 F. 2d 342, certiorari denied, 359 U.S. 927	18
Gold v. *Scurlock*, CCH Fed. Sec. L. Rep. ¶93,021	21
Gratz v. *Claughton*, 187 F. 2d 46, certiorari denied, 341 U.S. 920	19
J. I. Case Co. v. *Borak*, 377 U.S. 426	8
Kahansky v. *Emerson Radio & Phonograph Corp.*, 184 F. Supp. 90	21
Marquette Cement Manufacturing Co. v. *Andreas*, 239 F. Supp. 962	22
McDonald v. *Thompson*, 305 U.S. 263	20
Newmark v. *RKO General, Inc.*, 425 F. 2d 348, certiorari denied, 400 U.S. 854	19, 21
Ozawa v. *United States*, 260 U.S. 178	19–20
Petteys v. *Butler*, 367 F. 2d 528, certiorari denied *sub nom. Blau* v. *Petteys*, 385 U.S. 1006	17, 19
Piedmont & Northern Railway Co. v. *Interstate Commerce Commission*, 286 U.S. 299	20
Securities and Exchange Commission v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180	9
Securities and Exchange Commission v. *Custer Channel Wing Corp.*, 376 F. 2d 675, certiorari denied, 389 U.S. 850	20
Securities and Exchange Commission v. *Ralston Purina Co.*, 346 U.S. 119	20
Securities and Exchange Commission v. *Sunbeam Gold Mines Co.*, 95 F. 2d 699	20
Simon v. *Sunasco, Inc.*, CCH Fed. Sec. L. Rep. ¶92,547	21

Cases—Continued Page

Smolowe v. *Delendo Corp.*, 136 F. 2d 231, certiorari denied, 320 U.S. 751 ..... 18, 19

Spokane & Inland Empire Railroad Co. v. *United States*, 241 U.S. 344 20

Steinberg v. *Sharpe*, 95 F. Supp. 32, affirmed *per curiam*, 190 F. 2d 82 19

Stella v. *Graham-Paige Motors Corp.*, 104 F. Supp. 957, 132 F. Supp. 100, remanded, 232 F. 2d 299, certiorari denied, 352 U.S. 831 ..... 20, 21, 23, 25, 26

United States v. *American Trucking Associations, Inc.*, 310 U.S. 534 20

Western Auto Supply Company v. *Gamble-Skogmo, Inc.*, 348 F. 2d 736, certiorari denied, 382 U.S. 987 ..... 19, 23

Wolf v. *Weinstein*, 372 U.S. 633 8

Statutes:

Bankruptcy Act, Section 249, 11 U.S.C. 649 8

Securities Acts Amendments of 1964, Public Law 88–467, 88th Cong., 2d Sess., 78 Stat. 565 16

Securities Exchange Act of 1934, as amended:

Section 2, 15 U.S.C. 78b 8

Section 12, 15 U.S.C. 78*l* 2, 16

Section 16(a), 15 U.S.C. 78p(a) 2, 31

Section 16(b), 15 U.S.C. 78p(b) ..... *passim*

28 U.S.C. 1292(b) 7

Miscellaneous:

Feldman and Teberg, *Beneficial Ownership Under Section 16 of the Securities Exchange Act of 1934*, 17 Western Reserve L. Rev. (1966) 31

II Loss, *Securities Regulation* (2d ed. 1961) 31

Hearings Before the Senate Committee on Banking and Currency, 73d Cong., 1st and 2d Sess. 16, 17, 18, 31, 32, 33

Hearings Before the House Committee on Interstate and Foreign Commerce on H.R. 7852 and H.R. 8720, 73d Cong., 2d Sess 18, 32, 33

H. Rep. No. 1383, 73d Cong., 2d Sess 14

S. Rep. No. 792, 73d Cong., 2d Sess 15, 16, 17

S. Rep. No. 1455, 73d Cong., 2d Sess 14, 15, 30

Securities Exchange Act Release No. 79 (1935), reprinted in Release No. 1965 (1938), 11 F.R. 10967 31

Securities and Exchange Commission Rule 16a–4, 17 C.F.R. 240.16a–4 31

In the Supreme Court of the United States

OCTOBER TERM, 1971

No. 70–79

RELIANCE ELECTRIC COMPANY, PETITIONER

v.

EMERSON ELECTRIC COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

OPINIONS BELOW

The opinion of the court of appeals (App. 170–182) is reported at 434 F. 2d 918. The opinion of the district court (App. 157–165) is reported at 306 F. Supp. 588.

JURISDICTION

The judgment of the court of appeals (App. 183) was entered on November 12, 1970. The petition for a writ of certiorari was filed on February 9, 1971, and was granted on April 5, 1971 (401 U.S. 1008). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether a corporation may recover, under Section 16(b) of the Securities Exchange Act of 1934, profits realized by a person from a purchase followed within six months by sales of the corporation's stock, where such person becomes a more than 10 percent beneficial owner of the corporation's stock by virtue of the purchase and is a more than 10 percent beneficial owner at any time during the period in which the sale transactions occur.

STATUTE INVOLVED

Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(b), provides in pertinent part:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner,[1] director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months * * * shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of hold-

[1] The term "such beneficial owner" relates back to Section 16(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(a), which provides for the reporting of beneficial ownership of equity securities and changes in such ownership by, among others, "[e]very person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 12" of the Securities Exchange Act of 1934, 15 U.S.C. 78*l*.

ing the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

STATEMENT

This action was brought by Emerson Electric Company ("Emerson") for a declaratory judgment as to its liability under Section 16(b) of the Securities Exchange Act of 1934 to Reliance Electric Company ("Reliance") for short-swing profits made by Emerson in the purchase and subsequent sale of common stock of Dodge Manufacturing Company ("Dodge"), a company which, subsequent to the purchase and sale transactions, merged into Reliance.

The relevant facts concerning Emerson's purchase and sale of Dodge stock are undisputed. On May 22, 1967, Emerson made a tender offer for shares of

Dodge common stock at $63 per share (App. 15). Upon the expiration of the tender offer, Emerson, on June 16, purchased all 152,282 shares tendered (App. 15). These shares constituted 13.2 percent of the then outstanding common stock of Dodge (App. 17, 157). Until its purchase on June 16, Emerson did not own any shares of Dodge common stock (App. 15).

Prior to Emerson's purchase, Dodge, on June 1, 1967, entered into an agreement with Reliance whereby Dodge was to be merged into Reliance (App. 157–158). Emerson sought to prevent the merger, which needed stockholder approval, advocating instead a merger with Emerson (App. 63). A proxy contest ensued and, at a meeting of Dodge stockholders on August 22, 1967, the Dodge-Reliance merger was approved (App. 64–65).

Following its failure to block the merger, Emerson, on August 28, sold 37,000 shares of its Dodge stock at $68 per share to Goldman, Sachs & Company (App. 16), thereby reducing Emerson's holdings in Dodge to 115,282 shares, which constituted 9.96 percent of the then outstanding common stock (App. 17, 172). Shortly thereafter, negotiations were initiated on behalf of Dodge by Reliance for the purchase of the remaining shares of Dodge stock held by Emerson and on September 11, 1967, an agreement was executed for the sale of the stock at $69 per share (App. 16–17). In accordance with the agreement, the sale was consummated and closed on September 13, 1967 (App. 17). Emerson thus realized substantial profits from the purchase and the sale of both the

37,000 shares and the 115,282 shares of Dodge stock (App. 18). On September 29, 1967, Dodge merged into Reliance (App. 18).

Prior to the first sale of Dodge stock, Emerson's counsel, in a letter dated June 26, 1967 (App. 33–38), had suggested to Emerson alternatives on "how to dispose of, at a profit, the shares of Dodge stock which Emerson now owns" and proposed that Emerson "seek to avoid [Section 16(b)] consequences" through "[t]he initial defensive step" of reducing Emerson's holdings in Dodge to less than 10 percent (App. 36–38).

On February 13, 1968, prompted by a shareholder request that it take appropriate action to recover the profits realized by Emerson on the latter's purchase and sale of Dodge stock (App. 7), Reliance demanded that Emerson account to Reliance for the profits on Emerson's August 28 sale of 37,000 shares of Dodge stock, reserving the right to assert a claim with respect to profits made on the sale of the remaining 115,282 shares (App. 8–9). Faced with this demand, Emerson, on February 29, 1968, brought this action to determine its liability under Section 16(b) for the profits realized on its transactions in Dodge stock (App. 3). Reliance counterclaimed for the profits realized on Emerson's sale of all 152,282 shares of Dodge stock (App. 12).

After a trial on the issue of liability alone, the district court adjudged Emerson liable for the profits realized by it from the sale of all 152,282 shares of Dodge stock (App. 165), notwithstanding the exemp-

tive provision of Section 16(b), which provides in part that "[t]his subsection shall not be construed to cover any transaction where [a more than 10 percent] beneficial owner was not such both at the time of the purchase and sale * * * of the security involved * * *." The district court rejected Emerson's contention that it was not a more than 10 percent beneficial owner at the time of its purchase of 13.2 percent of Dodge stock (App. 158). It concluded that the "at the time of the purchase" requirement of the exemptive provision was satisfied if a shareholder became a more than 10 percent beneficial owner "simultaneously with" the purchase in question (App. 159). With respect to Emerson's profits realized on the second sale of the remaining 115,282 shares, at a time when Emerson was the beneficial owner of only 9.96 percent of Dodge stock, the court found that Emerson's two sale transactions, although "technically separate," were related parts of "a single pre-determined plan of disposition with the overall intent and purpose of avoiding Section 16(b) liability" (App. 163, 164). It concluded that Emerson cannot "excise 16(b) liability or 'avoid its consequences' by utilizing a series of related transactions, some of which considered separately might be exempt, when the obvious substance of the transaction as to a whole is the disposition of its more than 10% beneficial interest," and determined that "the 'time of sale' should include the entire period during which a series of related transactions take place pursuant to a plan by which a 10% beneficial owner disposes of his stock holdings" (App. 164).

On interlocutory appeal pursuant to 28 U.S.C. 1292(b), the court of appeals modified the judgment of the district court. It held Emerson liable for the profits realized on the first sale of Dodge stock, agreeing that the purchase by which one becomes a more than 10 percent beneficial owner is not excluded from Section 16(b) coverage by the exemptive provision (App. 177). It held, however, that Emerson was not liable for the profits on the second sale because the latter "was not made at the time Emerson was a more than 10 percentum stockholder * * *" (App. 182).

Although accepting the finding of the district court that Emerson's two sales were made pursuant to a predetermined plan to dispose of its entire stock holdings with the intent to avoid Section 16(b) liability for the profits realized on the second sale (App. 180), the court below concluded that "intent as such to avoid loss of realized profits by engaging in two independent sales * * * does not result in treating the two sales as one sale of the entire stock held, nor as one continuous transaction * * *" (App. 181–182). It stated that the "standards set forth in Sections 16(a) and 16(b) are arbitrary both in the selection of time, 6 months, and the selection of amount, more than 10 percentum," so that after a sale by which a beneficial owner's holdings are reduced to 10 percent or less "the arbitrary standards * * * are no longer met" and "subsequent sales literally fall within the exemption language of 16(b) * * *" (App. 181).

THE INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

For 37 years, Section 16(b) of the Securities Exchange Act of 1934 has played a major role in implementing the broad aim of Congress "to insure the maintenance of fair and honest markets" in securities transactions (Securities Exchange Act of 1934, Section 2, 15 U.S.C. 78b) by deterring "insiders" of publicly-held corporations—directors, officers and principal stockholders—from unfairly using corporate information to engage in short-swing speculative trading in their corporations' stock and from engaging in activities designed to manipulate the price of that stock. This Court has recognized the particular "prophylactic" effect of Section 16(b), *Blau* v. *Lehman*, 368 U.S. 403, 414, and, in noting the "common origins" of Section 16(b) and Section 249 of the Bankruptcy Act, 11 U.S.C. 649, has indicated that Section 16(b)'s underlying policies require an interpretation of its provisions which will afford a "pervasive and unbending rule against certain forms of insider trading * * *." *Wolf* v. *Weinstein*, 372 U.S. 633, 643 note 11.

The Commission is interested in assuring that judicial interpretation of Section 16(b), like the interpretation of other provisions of the federal securities laws, continues "to make effective the congressional purpose," *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 433, since the private action through which Section 16(b) is enforced complements the Commission's own enforcement actions under the antifraud and anti-manipulative provisions of the federal securities laws.

The Commission believes that the decision of the court of appeals constitutes an unwarranted departure from the principle that federal securities legislation is to be construed "flexibly to effectuate its remedial purposes." *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195.

INTRODUCTION AND SUMMARY

1. The district court, in holding Emerson liable under Section 16(b) for profits realized on both of Emerson's sales of Dodge stock, based its decision upon the finding that Emerson's two sale transactions were related parts of a single predetermined plan of disposition and thus should be treated as one "sale" within the meaning of the exemptive provision of Section 16(b). While we believe that the district court, in imposing liability with respect to both sales, reached the correct result, we are troubled by that court's reasoning. By making Section 16(b) liability turn upon proof that a more than 10 percent beneficial owner acted with a certain intent or state of mind—*i.e.*, that prior to the time the first of the two sale transactions was effected, he had already decided to dispose of all his holdings of the stock—the district court adopted an approach which, to a certain extent, conflicts with the congressional desire that Section 16(b) operate as objectively and automatically as possible.

The objective nature of the elements of a claim for relief under Section 16(b) operates to encourage those persons charged with Section 16(b)'s enforcement—primarily the issuer's security holders—to bring suits under the statute because of a recognition that recov-

ery will come swiftly and without the lengthy trial court proceedings which would result from factual inquiries into an insider's state of mind. In turn, recognition on the part of an insider of the high probability that an action will be instituted for profits he realizes on transactions effected within the six-month period, and that recovery will quickly be secured, contributes to the statutory goal of deterring short-swing trading on the basis of inside information. This deterrent effect which flows from an objective standard of liability would be weakened by the introduction of the district court's subjective test which, because of the difficulty of proving intent or state of mind, would often have the practical effect of foreclosing recovery of profits realized on the second of two sales. It is true that Reliance was able in the present case to prove that Emerson had a predetermined plan of disposition, but this was so because the plan had been outlined in a letter to Emerson by its counsel. It can be readily assumed, however, that a more than 10 percent beneficial owner who seeks to avoid Section 16(b) liability through the technique of effecting two sale transactions, and who knows that the profit realized on the second transaction may be recovered by the issuer only when it can be proved that the second transaction is part of a predetermined plan of disposition, will never again provide the issuer with documentary evidence of his intention.

Were there not an alternative interpretation of the exemptive provision of Section 16(b) which avoids the pitfalls of the district court's opinion,

we would urge acceptance of that court's approach since the exemptive provision should, at the least, not exclude from liability successive sales, within six months after a purchase, pursuant to a predetermined plan of disposition. In our view, however, the purpose and legislative history of Section 16(b) and its exemptive provision give compelling reasons to limit the exemptive provision even further; accordingly, we advance here an interpretation of that provision which avoids the need for subjective inquiries and which would subject Emerson's second sale transaction to liability whether or not Emerson had a predetermined plan of disposition.[2]

2. Our starting point is the legislative history of Section 16(b). Prior to the enactment of the statute, Congress had uncovered many instances where those in control of large corporations had used inside information or had manipulated the affairs of their

---

[2] In urging acceptance of the district court's approach as an alternative to the interpretation which we advance in this brief, we point out that the approach adopted by the district court does not go so far as to permit inquiry into whether the insider actually used or intended to use inside information or engaged or intended to engage in manipulative activities. Inquiry into such matters would be squarely in conflict with the congressional intent to adopt an objective standard.

We also note that although the district court found that Emerson's predetermined plan of disposition was, in fact, motivated solely for the purpose of avoiding Section 16(b) liability, its holding that Emerson's two sale transactions should be treated as one "sale" under Section 16(b) does not appear to have been based on the finding of such motivation. It was based only on the finding that Emerson's two sales were effected pursuant to a predetermined plan of disposition.

corporations to profit from short-term speculative trading in their corporations' securities. In enacting Section 16(b), Congress removed the incentive for engaging in such practices by providing that any profits realized by any officer, director or more than 10 percent beneficial owner of a corporation's stock from a purchase and sale or sale and purchase within six months would be recoverable automatically by or on behalf of the corporation irrespective of whether the insider had in fact used inside information or engaged in manipulative activity. The courts have recognized the intent of Congress to curb insider abuses and have broadly interpreted Section 16(b) to effectuate that intent.

Transactions of the type effected by Emerson in the instant case present the potential for the speculative and manipulative abuses which Section 16(b) was designed to prevent. The fact that Emerson was not a more than 10 percent beneficial owner prior to its purchase of Dodge stock but became such a statutory insider simultaneously with such purchase, and the fact that Emerson ceased to be a more than 10 percent beneficial owner prior to the second of its two sales effected within six months of the purchase, do not take the transactions out of the category of insider trading which is capable of abuse. Effectuation of the statute's prophylactic purposes accordingly requires that Section 16(b) liability be imposed on profits made on these transactions.

Turning to an analysis of the provision which exempts from Section 16(b) liability "any transaction

where [a more than 10 percent] beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved," we believe that the provision was not intended to afford a more than 10 percent beneficial owner, who voluntarily attains such status as a result of a purchase of stock of his corporation, a method by which he may structure his sale transactions within the six-month period and thereby avoid liability for a substantial portion of profits realized on such transactions. Rather, as the admittedly scant legislative history of the provision suggests, the exemption was intended to operate in situations where a person purchases stock of a corporation, subsequently becomes a more than 10 percent beneficial owner through circumstances other than a voluntary stock purchase, and then sells his stock within six months of the purchase. Since Emerson became a more than 10 percent beneficial owner as a result of a voluntary stock purchase and lost that status as a result of a voluntary stock sale, the exemption was not intended to be applicable here.

Finally, we believe that the exemptive provision can and should be interpreted to limit its application to those situations to which it was most likely intended to apply. In our view, the words "the * * * sale" in the phrase "both at the time of the purchase and sale" in the exemptive provision encompass a disposition of securities consisting of separate sale transactions occurring over a period of time. Under this construction, if a person was a more than 10 percent beneficial owner

440-192—71——3

at any time during the period in which the separate sale transactions occurred, then he had such status "at the time of the * * * sale."

ARGUMENT

A PERSON IS LIABLE UNDER SECTION 16(b) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR PROFITS REALIZED BY HIM FROM A PURCHASE FOLLOWED WITHIN SIX MONTHS BY SALES OF A CORPORATION'S STOCK, WHERE SUCH PERSON BECOMES A MORE THAN 10 PERCENT BENEFICIAL OWNER OF THE CORPORATION'S STOCK BY VIRTUE OF THE PURCHASE AND IS A MORE THAN 10 PERCENT BENEFICIAL OWNER AT ANY TIME DURING THE PERIOD IN WHICH THE SALE TRANSACTIONS OCCUR

A. EFFECTUATION OF SECTION 16(b)'S PROPHYLACTIC PURPOSES REQUIRES THE STATUTE'S APPLICATION TO ALL OF EMERSON'S TRANSACTIONS IN DODGE STOCK

1. Congress intended Section 16(b) broadly to eliminate profits made by insiders on transactions within a six-month period

In enacting Section 16(b) of the Securities Exchange Act of 1934, Congress sought "to protect the interests of the public against the predatory operations of directors, officers, and principal stockholders of corporations * * *." S. Rep. No. 1455, 73d Cong., 2d Sess., p. 68. The congressional study on which the Act was based had revealed widespread disregard by "corporate managers of [public] companies * * * of their responsibilities as trustees for their corporations," H. Rep. No. 1383, 73d Cong., 2d Sess., p. 13, and had uncovered flagrantly abusive practices by which those in control of large corporate enterprises used inside information to engage in speculative trading in the se-

curities of their corporations for personal profit. These practices were summarized as follows in one of the Committee reports (S. Rep. No. 1455, 73d Cong., 2d Sess., p. 55):

> Among the most vicious practices unearthed at the hearings before the subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities. Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others. * * *[3]

Moreover, Congress found that the possibility that insiders might profit from trading in their corporations' stock led to the deliberate manipulation by insiders of the financial policies of their corporations, without regard for the best interests of the corpora-

[3] The most common examples of abuse cited in the legislative history of the Act were instances where insiders either (1) had bought stock knowing that favorable corporate information was about to be made public and then sold the stock after the market price of the stock had risen following publication of the information or (2) had sold stock with advance notice of unfavorable information and then bought back the stock after publication had depressed the market price of the stock. See S. Rep. No. 1455, 73d Cong., 2d Sess., pp. 55–68; S. Rep. No. 792, 73d Cong., 2d Sess., p. 9.

tion, for the purpose of producing sudden changes in the market price of their stock. See, *e.g.*, S. Rep. No. 792, 73d Cong., 2d Sess., pp. 7–9. As stated by Senator Gore at the hearings which ultimately led to the statute's enactment, "[Section 16(b)] is aimed at the general evil of officers and directors rigging their stock up and down, and squeezing out their own stockholders." Hearings Before the Senate Committee on Banking and Currency pursuant to S. Res. 84 (72d Cong.) and S. Res. 56 and 97 (73d Cong.), 73d Cong., 1st & 2d Sess., p. 6559 (hereinafter "Senate Hearings").

To prevent effectively these and similar practices, Congress in Section 16(b) adopted an objective "rule-of-thumb" prophylaxis, whereby profits realized by a director, officer or more than 10 percent beneficial owner (hereinafter "10 percent beneficial owner")[4] from "any purchase and sale" or "any sale and purchase" of any equity security of his corporation within a period of less than six months are recoverable by or on behalf of the corporation[5] without proof of the

---

[4] It was noted at the hearings that ownership of ten percent of a corporation's stock would often result in control of the corporation and thus would be sufficient to enable a person to acquire confidential information. See Senate Hearings, pp. 6556, 7741–7742.

[5] Prior to the enactment of the Securities Acts Amendments of 1964, Public Law 88–467, 88th Cong., 2d Sess., 78 Stat. 565, Section 16(b) was applicable only to corporations whose securities were registered on a national securities exchange. The 1964 amendments enlarged the coverage of Section 16(b) to encompass all companies with securities registered pursuant to Section 12 of the Securities Exchange Act of 1934, 15 U.S.C. 78*l*, thereby including certain companies whose securities are traded in the over-the-counter market.

actual use of inside information or of the existence of a manipulative purpose, or proof that at the time of purchase there was an intention to sell within six months.[6] By adopting the six-month period, Congress sought to avoid adversely affecting long term investment by those who manage and control a company while at the same time discouraging short-swing trading by insiders which Congress found served no useful function, see S. Rep. No. 792, 73d Cong., 2d Sess., p. 6, and which was fraught with the greatest danger of unfair use of inside information and temptation to indulge in manipulative activity.

In short, Section 16(b) was designed to implement a policy seeking to protect the investing public against practices that had caused it great injury. Notwithstanding the fact that recovery under the Section inures to the immediate benefit of the corporation, the statute is intended to ensure the strict observance of

---

[6] The need for an objective standard was explained at the hearings by Thomas G. Corcoran, the administration's spokesman for the legislation (Senate Hearings, p. 6557):

"You hold the director, irrespective of any intention or expectation to sell the security within 6 months after, because it will be absolutely impossible to prove the existence of such intention or expectation, and you have to have this crude rule of thumb, because you cannot undertake the burden of having to prove that the director intended, at the time he bought, to get out on a short swing."

The strictness of the provision is somewhat mitigated by the fact that it merely requires the insider to give up "any profit realized" within the six-month period; Section 16(b) does not make it unlawful to engage in purchases and sales within that period. *Petteys* v. *Butler*, 367 F. 2d 528, 532 (C.A. 8), certiorari denied *sub nom. Blau* v. *Petteys*, 385 U.S. 1006. Thus, an insider may recover up to his original investment by selling his stock within the six-month period. Senate Hearings, p. 6557.

corporate insiders' fiduciary duties to other stockholders through the elimination of the incentive which would prompt an insider to engage in manipulative activity or use inside information obtained from his position of trust to trade in the stock of his corporation. See Hearings Before the House Committee on Interstate and Foreign Commerce on H.R. 7852 and H.R. 8720, 73d Cong., 2d Sess., pp. 85, 132–133 (hereinafter "House Hearings"); Senate Hearings, p. 7742. In turn, Section 16(b)'s deterrent effect is grounded upon an insider's recognition that the statute will be thoroughgoing in requiring disgorgement of profits made on transactions in his corporation's securities occurring within a period of six months.

2. Section 16(b), like other remedial legislation, has been broadly interpreted in order to effectuate the congressional intent

In recognition that Section 16(b) is a remedial measure designed "to squeeze all possible profits out of stock transactions" by insiders, *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231, 239 (C.A. 2), certiorari denied, 320 U.S. 751, and thus to deter the unfair use of inside information, the courts have consistently interpreted the statute broadly and against the insider.[7]

[7] Thus, short-swing trading profits are subject to recovery even though the insider in fact had no inside information (see *Smolowe* v. *Delendo Corp.*, *supra*, 136 F. 2d at 236; *Blau* v. *Lehman*, 286 F. 2d 786, 791 (C.A. 2), affirmed, 368 U.S. 403; *Ferraiolo* v. *Newman*, 259 F. 2d 342, 344 (C.A. 6), certiorari denied, 359 U.S. 927); where a series of transactions within six months has resulted in some profits and some losses, the lowest purchase price has been matched against the highest sales price

As the Second Circuit stated in *Feder* v. *Martin Marietta Corp.*, 406 F. 2d 260, 262, certiorari denied, 396 U.S. 1036:

> The judicial tendency * * * has been to interpret Section 16(b) in ways that are most consistent with the legislative purpose, even departing where necessary from the literal statutory language. * * *

This tendency, of course, is fully consistent with decisions of this Court giving primary emphasis to the congressional purpose underlying a statute, even "sacrificing, if necessary, the literal meaning in order that the purpose may not fail." *Ozawa* v. *United*

---

to determine the profits recoverable under Section 16(b) without offsetting the losses (see *Smolowe* v. *Delendo Corp.*, *supra*, 136 F. 2d at 239; *Gratz* v. *Claughton*, 187 F. 2d 46, 49 (C.A. 2), certiorari denied, 341 U.S. 920; *Adler* v. *Klawans*, 267 F. 2d 840, 847–848 (C.A. 2); *Western Auto Supply Company* v. *Gamble-Skogmo, Inc.*, 348 F. 2d 736, 742–743 (C.A. 8), certiorari denied, 382 U.S. 987; *Petteys* v. *Butler*, *supra*, 367 F. 2d at 531–532); the granting of an option by an insider within six months of a purchase has been considered a "sale" within the meaning of Section 16(b) even though the option was not exercised until after the six-month period had run (see *Bershad* v. *McDonough*, 428 F. 2d 693 (C.A. 7), certiorari denied, 400 U.S. 992); and various mergers, exercises of stock options and other transactions have been found to constitute "purchases" or "sales" where necessary to effectuate the purposes underlying Section 16(b) (see, *e.g.*, *Blau* v. *Lehman*, *supra* 286 F. 2d 786; *Blau* v. *Mission Corp.*, 212 F. 2d 77 (C.A. 2), certiorari denied, 347 U.S. 1016; *Newmark* v. *RKO General, Inc.*, 425 F. 2d 348 (C.A. 2), certiorari denied, 400 U.S. 854; *Steinberg* v. *Sharpe*, 95 F. Supp. 32 (S.D.N.Y.), affirmed *per curiam*, 190 F. 2d 82 (C.A. 2); *Blau* v *Hodgkinson*, 100 F Supp. 361 (S.D.N.Y.)).

States, 260 U.S. 178, 194. See also *United States* v. *American Trucking Associations, Inc.*, 310 U.S. 534, 543; *Commissioner of Internal Revenue* v. *Estate of Sternberger*, 348 U.S. 187, 206.

Statutory exemptions to remedial legislation such as the federal securities laws, in the absence of clear proof that Congress intended otherwise, have consistently been construed strictly. See *Spokane & Inland Empire Railroad Co.* v. *United States*, 241 U.S. 344, 350; *Piedmont & Northern Railway Co.* v. *Interstate Commerce Commission*, 286 U.S. 299, 311–312; *McDonald* v. *Thompson*, 305 U.S. 263, 266; *Securities and Exchange Commission* v. *Ralston Purina Co.*, 346 U.S. 119, 126–127; *Securities and Exchange Commission* v. *Sunbeam Gold Mines Co.*, 95 F. 2d 699, 701 (C.A. 9); *Capital Funds, Inc.* v. *Securities and Exchange Commission*, 348 F. 2d 582, 586 (C.A. 8); *Securities and Exchange Commission* v. *Custer Channel Wing Corp.*, 376 F. 2d 675, 678 (C.A. 4), certiorari denied, 389 U.S. 850. The courts have applied this principle in interpreting the provision in Section 16(b) involved in this case, which exempts from coverage

> * * * any transaction where [a more than 10 percent] beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved * * *.

In *Stella* v. *Graham-Paige Motors Corp.*, 232 F. 2d 299 (C.A. 2), certiorari denied, 352 U.S. 831, the Second Circuit sustained the holding of the district court, 104 F. Supp. 957 (S.D.N.Y.), that profits made on a

purchase and sale of securities within six months by a 10 percent beneficial owner who, while not such prior to his purchase, became such as a result of that purchase, were recoverable under Section 16(b). Noting that the legislative purpose would be frustrated were the purchase by which one becomes a 10 percent beneficial owner excluded from the statute's coverage, the district court construed the phrase "at the time of" in the exemption as meaning "simultaneously with" the purchase transaction. *Id.* at 959. In holding that Emerson's purchase of 13.2 percent of Dodge stock made Emerson at the time of that very purchase a 10 percent beneficial owner within the meaning of Section 16(b), the court below followed *Stella* as has virtually every other court that has considered the question (App. 174–179). See *Newmark* v. *RKO General, Inc., supra,* 425 F. 2d at 355–356; *Bershad* v. *McDonough, supra* (alternative basis for liability); *Kahansky* v. *Emerson Radio & Phonograph Corp.,* 184 F. Supp. 90, 94 (S.D.N.Y.); *Abrams v. Occidental Petroleum Corp.,* 323 F. Supp. 570, 579 (S.D.N.Y.), appeal pending; *Simon* v. *Sunasco, Inc.,* CCH Fed. Sec. L. Rep. ¶92,547 (S.D.N.Y.); *Gold* v. *Scurlock,* CCH Fed. Sec. L. Rep. ¶93,021 at 90,771 (E.D.Va.). But see *Arkansas Louisiana Gas Co.* v. *W. R. Stephens Investment Co.,* 141 F. Supp. 841 (W.D. Ark.).

Although the statutory exemption was not directly involved, Section 16(b) has also been held to apply to the purchase and sale by a director who had purchased stock of a company immediately before he became a

director and had sold it at a profit after becoming a director and within six months of the purchase. *Adler* v. *Klawans*, 267 F. 2d 840 (C.A. 2). See *Bershad* v. *McDonough, supra* (alternative basis for liability); *Blau* v. *Allen*, 163 F. Supp. 702 (S.D.N.Y.); *Marquette Cement Manufacturing Co.* v. *Andreas*, 239 F. Supp. 962 (S.D.N.Y.). And in *Feder* v. *Martin Marietta Corp., supra*, purchases by a director were matched against sales made within six months but after the director had resigned. In both *Adler* and *Feder*, the Second Circuit determined that the transactions effected by the respective directors presented the opportunity for abuse of inside information that the statute was designed to prevent.

3. The purchase by which one becomes a 10 percent beneficial owner, followed within six months by two sales, the second of which is made at a time when the seller no longer is a 10 percent beneficial owner, is a series of transactions capable of the insider abuses Section 16(b) was designed to prevent

The insider abuses Section 16(b) was designed to prevent are most readily apparent where the insider—be he officer, director or 10 percent beneficial owner—

is in that status both prior to the first transaction of purchase or sale and after the last sale or purchase. Under such circumstances, the possibility exists that initial purchases or sales can be made on the basis of undisclosed favorable or unfavorable corporate information to be followed by sales or purchases once the market price of the stock has adjusted to public disclosure of the information. As previously discussed (see n. 3, *supra*), this type of trading by insiders—on the basis of *advance* information—was one of the very evils Congress sought to eliminate in enacting Section 16(b). But, as the *Stella, Adler* and *Feder* cases recognized, the potential for abuse also exists where, as in the case of Emerson here, a person becomes a statutory insider simultaneously with or after an initial purchase and loses that status prior to a final sale consummated within six months.[8]

a. There are at least three ways in which the insider abuses sought to be prevented by the statute could

[8] We do not claim that Emerson, in its transactions in Dodge stock, actually used inside information or engaged in manipulative conduct. But that issue is immaterial. For, there cannot be "one rule for insiders with good intentions and another for those who would flagrantly abuse their trust." *Western Auto Supply Co.* v. *Gamble-Skogmo, Inc.*, *supra*, 348 F. 2d at 743. Nor do we claim that Emerson, in fact, had access to inside information or had sufficient control of Dodge to enable Emerson to manipulate Dodge's affairs. The statute makes irrelevant such an inquiry. See nn. 4 and 7, *supra*.

occur where insider status is attained simultaneously with or shortly after an initial purchase. First, a person who becomes a 10 percent beneficial owner as a result of a purchase of a large block of stock may have obtained advance inside information prior to the purchase through negotiations for the purchase with the corporation or a substantial stockholder. In that case, such a person would have been in a position to bargain for disclosures not available to outside stockholders; he could then purchase the stock of the issuer on the basis of the advance information so obtained, and then sell the stock at a profit. Similarly, an officer or director of a corporation may have obtained such information in negotiations prior to accepting the position.

Second, a person may purchase a large block of stock (more than 10 percent) in a corporation in anticipation of engaging in manipulative practices upon becoming an insider which would raise the market price of the stock and enable him to sell his stock at a profit.

Finally, although a person may purchase stock simultaneously with or prior to becoming an insider without any advance inside information or intent to manipulate the corporation's affairs upon becoming an insider, he could nevertheless obtain information or engage in manipulative activity after having become an insider which could be capitalized upon in effect-

ing a subsequent sale of the stock.[9] Such short-swing profit making goes to the core of Section 16(b), which was designed not only to deter the misuse of inside information obtained in advance of an initial purchase, but, as the broad language of the Section's preamble suggests—"For the purpose of preventing the unfair use of information which may have been obtained by * * * [an insider] by reason of his relationship to the issuer" (p. 2, *supra*)— to prevent misuse of such information regardless of whether obtained before or after the initial purchase.

In following *Stella* v. *Graham-Paige Motors Corp., supra*, and its progeny, the court below specifically recognized that the purchase by a previous non-insider of a large block of stock could lead to opportunities to profit from inside information and manipulation and that "deterrence of such apparent potential mischief must have been within the contemplation of Congress" (App. 179). But the court did not make a similar analysis of the potential evils flowing from sales consummated following the termination of insider status.

---

[9] The potential for this type of abuse is well illustrated by the *Adler* case where a director purchased stock of the issuer immediately before assuming that position and then sold the stock within six months. The court pointed out that within a week after the director had moved a resolution at a director's meeting that the company purchase 4,800 shares of its own stock on the market, he sold 9,000 shares of his stock. The sale, of course, was effected with the knowledge that the purchases by the company would tend to support the market price in the face of his sale of a substantial amount of the company's stock. By timing his sale to coincide with the company's purchases, he profited from the use of the inside information. *Adler* v. *Klawans*, *supra*, 267 F. 2d at 845–846.

b. The potential for insider abuse does not cease merely because a director resigns or a stockholder reduces his holdings to below 10 percent. A statutory insider may purchase stock on the basis of favorable inside information or pursuant to a manipulative scheme, with the intention of making a short-swing profit on a later sale once the inside information is made public or the manipulative scheme produces a price rise. In either case, the sale is but a vehicle for realizing the profits; its occurrence after the loss of insider status is immaterial. Finally, inside information obtained after a purchase but prior to the loss of insider status may be used unfairly in connection with a sale effected several months after the loss of insider status since the information could continue to be valuable during that short period. See *Feder* v. *Martin Marietta Corp., supra*, 406 F. 2d at 268.

Based on the foregoing, there can be no doubt from a policy point of view that Emerson's transactions in Dodge stock should be subjected to Section 16(b) regulation, in the same manner as liability was imposed in *Stella* and *Adler*, where insider status did not exist prior to the first of the pair of transactions of purchase and sale, and in *Feder*, where insider status had ceased prior to the second of the pair of transactions. If Emerson had made its purchase with the intent to manipulate the affairs of Dodge, both of the sale transactions by which Emerson disposed of its holdings would have been apt vehicles for making short-swing profits once

Emerson's manipulative intent was realized. Moreover, if, upon becoming a 10 percent beneficial owner as a result of its purchase, Emerson had then obtained information by reason of its insider position, both of its sales would have constituted transactions by which such information could have been used to make profits. As previously noted (see n. 8, *supra*), the fact that Emerson may not have actually engaged in manipulation or actually used inside information is irrelevant under Section 16(b).

Notwithstanding the fact that the transactions in the instant case, including the second sale transaction, presented the opportunity for insider abuse, the court below held that Emerson's profit on the second sale was not subject to recovery under Section 16(b). In so holding, the court sanctioned a procedure whereby a 10 percent beneficial owner may engage in short-swing trading in stock of his corporation and be assured of profits with respect to such trading on up to 10 percent of the corporation's outstanding stock which he owns. The ruling below is, therefore, in contravention of Congress' intent to remove profits made on insider trading within six months and seriously undermines the statute's prophylactic effect by providing the very profit incentive which would encourage a 10 percent beneficial owner to use unfairly inside information and engage in manipulative activity.

B. NEITHER THE PURPOSE NOR THE LANGUAGE OF THE EXEMPTIVE PROVISION IN SECTION 16(b) WARRANTS EXCLUDING FROM THE STATUTE'S OPERATION ANY OF EMERSON'S TRANSACTIONS IN DODGE STOCK

In light of the broad congressional purposes underlying the enactment of Section 16(b), the practice of the courts to interpret the statute and its exemptive provision consistently with those purposes, and the fact that transactions such as the ones involved here may be the subject of the very abuses sought to be abolished by Congress, we turn now to an analysis of the provision of Section 16(b) which the court below ruled absolved Emerson of liability for the profits made on its second sale of Dodge stock. That provision, as we have noted, exempts from liability

> * * * any transaction where [a more than 10 percent] beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved * * *.

The court below held that the statute does not reach the profits made on Emerson's second sale because the second sale was not made at a time when Emerson was a 10 percent beneficial owner and the exemptive provision's "arbitrary standards" conditioned liability on a 10 percent beneficial owner being such "both at the time of the purchase and sale" (App. 181–182). The court concluded that the literal language of the exemptive provision required such a result and it was "un-

able to discern from any of the congressional hearings or from the broad basic purpose of 16(b) any intent on the part of Congress not to mean what it has literally said in the 16(b) exclusion clause" (App. 182). In our view, however, neither the language nor the legislative history of the statute requires the result the court of appeals reached; we submit that our interpretation of the exemptive provision better effectuates the policy underlying Section 16(b) than does the interpretation of the court of appeals.

1. The exemptive provision was not intended to preclude liability for profits made on transactions within the six-month period by a 10 percent beneficial owner who acquires such status by a voluntary purchase

The exemptive provision in Section 16(b), by conditioning liability for short-swing profits of a 10 percent beneficial owner—but not the liability of a director or officer—upon his being such "both at the time of the purchase and sale," evidences a legislative intent to treat 10 percent beneficial owners differently from officers and directors. *Feder* v. *Martin Marietta Corp., supra,* 406 F. 2d at 266–267; *Adler* v. *Klawans, supra,* 267 F. 2d at 845. We believe that the different treatment accorded 10 percent beneficial owners was prompted by a recognition that, while officers and directors can only become statutory insiders by voluntarily assuming the position of officer or director of a corporation, a 10 percent beneficial owner may at-

tain or lose such statutory insider status by means other than a voluntary purchase or sale of stock.[10]

A person owning less than 10 percent of the stock of a corporation may have his interest increased to more than that amount through the purchase by the corporation of part of its outstanding securities, partial redemption of stock by the corporation, devise or gift of the corporation's stock, or acquisition of stock incident to service as an executor or trustee or in a similar fiduciary capacity. In many of these instances, the event by which one attains such status would not be subject to his control and, indeed, might even occur without his awareness. Two examples are illustrative:

(1) A, owning no stock of X Corporation, purchases 8 percent of the corporation's stock on January 1. On February 1, X Corporation, without A's knowledge, purchases enough of its stock so that A's percentage of outstanding stock is increased to 11 per-

[10] One court has suggested that the basis for distinction in Section 16(b) between 10 percent beneficial owners on the one hand and officers and directors on the other is that "officers and directors have more ready access to the intimate business secrets of corporations and factors which can affect the real and ultimately the market value of stock than does even so large a stockholder as a '10% beneficial owner.'" *Adler* v. *Klawans*, *supra*, 267 F. 2d at 845. We have found nothing in the legislative history, however, which suggests a congressional belief that large stockholders as a class had any less access to inside information than officers and directors. Indeed, the congressional study on which the Act was based indicates that in almost every instance where speculative and manipulative abuses occurred, large stockholders played a major role in their perpetration. See, *e.g.*, S. Rep. No. 1455, 73d Cong., 2d Sess. 55–68.

cent, thus making him a statutory insider. On March 1, A sells all his stock.

(2) On January 1, B purchases 6 percent of the stock of Y Corporation. Thereafter, on February 1, C, owning 5 percent of Y Corporation's stock, dies, naming B as executor of his estate. As a result, B acquires C's stock, and arguably might thereby be deemed a 10 percent beneficial owner within the meaning of the statute.[11] On March 1, B finds it necessary to

[11] The term "beneficial owner" as used in Section 16 was considered at the hearings to be "the broadest term you can have," Senate Hearings p. 6556, apparently embracing persons owning securities other than record owners who hold *only* bare legal title and who therefore have custody but not control over the securities, as in the case of a nominee. II Loss, *Securities Regulation*, pp. 1100, 1106 (2d ed. 1961). Accordingly, an executor or other fiduciary might be considered as beneficially owning securities held by him in his fiduciary capacity. See Senate Hearings, p. 7235; Feldman and Teberg, *Beneficial Ownership Under Section 16 of the Securities Exchange Act of 1934*, 17 Western Reserve L. Rev. 1054 (1966).

Example 2 set forth in the text assumes that there is a *possibility* that the term "beneficial owner" in Section 16(b) might be construed as requiring that the securities held by the executor in the estate be aggregated with his personal holdings in determining whether he is a 10 percent beneficial owner. We are not suggesting that the statute would necessarily be so construed. Indeed, in the case of securities held by a trustee, an early opinion of the Commission's General Counsel dealing with beneficial ownership under Section 16(a) expressed the view that under certain circumstances the statute does not require such aggregation. Securities Exchange Act Release No. 79 (1935), reprinted in Release No. 1965 (1938), 11 F.R. 10967, 10970–71. But the adoption by the Commission of Rule 16a–4, 17 C.F.R. situations (and also in a separate subdivision, exempting the type of transaction described in example 2) implicitly recognizes that the term "beneficial owner" might be construed as requiring aggregation. We believe that this possibility was among the reasons which led Congress to enact the statutory exemptive provision (see pp. 32–34, *infra*).

sell the stock he holds as executor for the purpose of paying creditors of the estate.

In the absence of the statutory exemptive provision, Section 16(b) might be construed as imposing liability on both A and B for any profits realized on their sales that occurred within six months of their purchases. Liability under the circumstances, however, might be considered inequitable in A's case, because he did not assume the status of a 10 percent beneficial owner voluntarily and indeed was unaware of his status, and in B's case since it would interfere with the performance of his fiduciary obligations as an executor. The exemptive provision would preclude liability in either case since neither A nor B was a 10 percent beneficial owner contemporaneously with his initial purchase.[12]

The admittedly scant legislative history of the exemptive provision suggests that Congress included it to avoid this type of situation. The failure of the initial draft of the statute to contain an exemptive provision[13] was the subject of specific criticism on the grounds of the adverse effect Section 16(b) might have upon the administration of decedents' estates and upon banks acting as trustees or in similar representa-

[12] Congress might also have felt that the risk of insider abuse in many situations where 10 percent beneficial owner status is acquired other than by a voluntary purchase would be significantly less than the risk where such status is attained voluntarily. This would be the case in our first example where A was unaware of his status as a 10 percent stockholder.

[13] Section 15(b) of both S. 2693 and H.R. 7852, 73d Cong., 2d Sess., the first public draft of Section 16(b), did not contain the exemption clause. See Senate Hearings, pp. 6422, 6430; House Hearings, pp. 1, 9. Public hearings were held on S. 2693 and H.R. 7852 by the Senate and House of Representatives, re-

tive capacities. Senate Hearings, pp. 6558, 7226, 7235. The following exchange at the hearings occurred between Senators Kean and Carey and Mr. Corcoran, one of the principal draftsmen of the statute (Senate Hearings, p. 6558; emphasis added):

> Senator CAREY. Suppose this stock passed to an estate, and the estate had to raise money?
>
> Mr. CORCORAN. I do not think, in that case, sir, the statute would apply.
>
> Senator KEAN. Why not?
>
> Senator CAREY. The estate is the beneficiary.
>
> Mr. CORCORAN. I do not believe it would. *Certainly the intention was that it should not apply to that sort of a situation.*

In the light of those circumstances and Mr. Corcoran's statement, Congress presumably added the exemption—which was incorporated into a substitute bill that was introduced in response to "legitimate criticisms" of the original bill made at the hearings (see note 13, *supra*)—to avoid the possibility that Section 16(b) would be applied to those situations.[14]

---

spectively, between February 14, 1934, and March 16, 1934. On March 19, 1934, a substitute bill, H.R. 8720, 73d Cong., 2d Sess., was introduced revising provisions in H.R. 7852 in response to "legitimate criticisms" raised at the hearings. House Hearings, pp. 625. Section 15(b) of that substitute bill contained the exemption for 10 percent beneficial owners which now appears in the statute. *Id.* at 637.

[14] If we are correct in our belief that Congress intended the exemptive provision to be limited to situations where 10 percent beneficial owner status is acquired other than by voluntary purchase, then the provision would be similarly limited to situations where such status is lost other than by voluntary sale, since Congress did not differentiate between the two situations.

In short, the exemptive provision of Section 16(b) was designed to avoid liability for changes in 10 percent beneficial owner status resulting from other than a voluntary purchase or sale, and not in situations, like the present one, involving a voluntary assumption of insider status by a purchase and a voluntary relinquishment of that status by a series of sales. We now show that the language of the exemptive provision is capable of a construction which is consistent with that design.

2. The language in the exemptive provision may properly be construed as not excluding from Section 16(b)'s coverage any sale transactions effected within six months after a purchase by which a person becomes a 10 percent beneficial owner where such person is a 10 percent beneficial owner at any time during the period in which the sale transactions occur

The court of appeals, in concluding that the literal language of the exemptive provision excluded Emerson's second sale from Section 16(b)'s coverage, construed the words "the * * * sale" in the phrase "both at the time of the purchase and sale" as meaning a single sale transaction which occurs at a single time. Since Emerson was not a 10 percent beneficial owner at the time of its second sale transaction, the court concluded that that sale was exempt from Section 16(b) coverage.

We submit, however, that in order to effectuate the policy of Section 16(b) to curb insider abuses and in keeping with the settled judicial practice of construing exemptions from remedial legislation narrowly (see p. 20, *supra*), the words "the * * * sale" in the exemptive phrase should be interpreted to encompass a disposition of securities consisting of separate sale trans-

actions occurring over a period of time. Such a construction would have the effect of recognizing only a loss of 10 percent beneficial owner status that stems from an event other than a voluntary sale and would thus be consistent with the probable congressional motive for inserting the exemptive provision (see note 14, *supra*).

To illustrate the construction we urge, consider a person who buys 3,000 shares of stock of a corporation on January 1 and then sells the stock in three blocks of 1,000 shares each during the period April 15 through June 15. While for some purposes, such as the mechanics of delivery and payment, he may be said to have engaged in three separate "sales," he may also be said to have in economic substance engaged in the disposition, or "the * * * sale," of the 3,000 shares. We urge the latter construction for the purpose of applying the exemptive provision of Section 16(b). Thus, if at *any* time during the period in which the three sale transactions occurred he was the beneficial owner of more than 10 percent of the corporation's stock, then he had such status "at the time of the * * * sale."

In the instant case, Emerson was a 10 percent beneficial owner at a time during the period of sale since it was a 10 percent beneficial owner at the time of the first sale transaction. Thus, the conditions necessary for the exemptive provision to operate were not met and accordingly Emerson's second sale transaction should not be excluded from the coverage of Section 16(b).

Although the language of the exemptive provision may be construed otherwise, we believe that our construction best comports with the overall prophylactic

scheme to curb insider abuses embodied in Section 16(b). As the Second Circuit stated in *Adler* v. *Klawans, supra,* 267 F. 2d at 844:

> In addition to the intent and purpose of the legislation which we must glean from the statute as a whole rather than from isolated parts, we must consider the results which would flow from each of the two interpretations contended for. If we find one interpretation tends to carry out and the other to defeat the purposes of the statute, the resolution of the issue becomes simple.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed in so far as it exonerates Emerson from liability under Section 16(b) for the profits realized upon its second sale of Dodge stock.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.
SAMUEL HUNTINGTON,
Assistant to the Solictor General.
PHILIP A. LOOMIS, Jr.,
General Counsel,
WALTER P. NORTH,
Associate General Counsel,
JACOB H. STILLMAN,
Assistant General Counsel,
FREDERIC T. SPINDEL,
Attorney,
Securities and Exchange Commission.

AUGUST 1971.

U.S. GOVERNMENT PRINTING OFFICE: 1971

MOTION FILED
OCT 1971
U.S.

IN THE

Supreme Court of the United States

OCTOBER TERM 1971

No. 1332

RELIANCE ELECTRIC COMPANY,
Petitioner,

v.

EMERSON ELECTRIC COMPANY,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MOTION OF GULF & WESTERN INDUSTRIES, INC. FOR LEAVE TO FILE THE ACCOMPANYING BRIEF AS AMICUS CURIAE IN SUPPORT OF THE POSITION OF THE RESPONDENT

WHITNEY NORTH SEYMOUR,
One Battery Park Plaza
New York, New York 10004
Counsel for Gulf & Western Industries, Inc.

Of Counsel:
JOHN A. GUZZETTA
BERNHARDT K. WRUBLE
Simpson Thacher & Bartlett

INDEX

	PAGE
MOTION	1
The Decision Below	1
The Interest of Gulf & Western Industries, Inc.	2
Questions That May Not Adequately Be Presented by the Parties	3
BRIEF	5
Jurisdiction	5
Question Presented	5
Statement	5
Statute Involved	6
Argument:	
Section 16(b) Accords Different Treatment To Official Insiders (Officers And Directors) Than To Large Shareholders Of The Corporation, Based Upon A Distinction Which Attributes To The Former Not Only Knowledge Of Inside Events, But Also A Capacity To Manipulate The Affairs Of The Corporation To Create Events Which Will Affect The Market Value Of The Stock, And Attributes To The Latter Mere Access To Inside Information. Unless Supplemented By Other Proof, The Transaction By Which A Person Without A Prior Relationship To The Issuer Corporation Acquires The Statutorily Prescribed Percentage Of Shares Is And Should Be Excluded From Section 16(b)'s Operation	7
1. The legislative history of Section 16(b) supports the aforesaid distinction between official and nonofficial insiders	7
2. The reasons offered by the SEC for charging the transaction by which one becomes a ten percent beneficial owner are unsound	17

PAGE

3. The rule should be that the transaction by which a person acquires more than 10 percent of a corporation's outstanding shares may or may not be charged under Section 16(b), depending upon whether the operative facts show the reasonable possibility of an abuse which the statute was designed to remedy 24

Conclusion 35

CITATIONS

Cases

Abrams v. *Occidental Petroleum Corp.*, 323 F. Supp. 570 (S.D.N.Y. 1971), *appeal argued and decision pending*, Doc. Nos. 71-1273-4-5-6 (2 Cir.) 25

Adler v. *Klawans*, 267 F.2d 840 (2 Cir. 1959) 13, 14, 15, 16, 18, 23, 33

Allis-Chalmers Manufacturing Co. v. *Gulf & Western Industries, Inc.*, Doc. No. 70 C 513 (N.D. Ill.) 2, 25

Alloys Unlimited, Inc. v. *Gilbert*, 319 F. Supp. 617 (S.D.N.Y. 1970) 24

Arkansas Louisiana Gas Co. v. *W. R. Stephens Investment Co.*, 141 F. Supp. 841 (W.D. Ark. 1956) 25, 30

Bershad v. *McDonough*, 428 F.2d 693 (7 Cir. 1970) 26

Blau v. *Lamb*, 363 F.2d 507 (2 Cir. 1966), *cert. denied*, 385 U. S. 1002 (1967) 22, 25, 28, 34, 35

Blau v. *Lehman*, 368 U. S. 403 (1962) 17, 19, 31, 32, 33, 34, 35

Blau v. *Lehman*, 286 F.2d 786 (2 Cir. 1960), *aff'd*, 368 U. S. 403 (1962) 32

Blau v. *Max Factor & Co.*, 342 F.2d 304 (9 Cir.), *cert. denied*, 382 U. S. 892 (1965) 23

Chemical Fund, Inc. v. *Xerox, Inc.*, 377 F.2d 107 (2 Cir. 1967) 24

PAGE

Ferraiolo v. *Newman*, 259 F.2d 342 (6 Cir. 1958), *cert. denied*, 359 U. S. 927 (1959) 10, 24

Gold v. *Scurlock*, CCH Fed. Sec. L. Rep. ¶ 93,021 (E. D. Va. 1971) 26

Mueller v. *Korholtz*, — F.2d — (7 Cir. 1971), 1971 CCH Fed. Sec. L. Rep. ¶ 93,222 24

Newmark v. *RKO General, Inc.*, 425 F.2d 348 (2 Cir.), *cert. denied*, 400 U. S. 854 (1970) 14, 17, 19, 25, 29, 30

Park & Tilford, Inc. v. *Schulte*, 160 F.2d 984 (2 Cir.), *cert. denied*, 332 U. S. 761 (1947) 25, 26

Pettys v. *Butler*, 367 F.2d 528 (8 Cir. 1966), *cert. denied*, 285 U. S. 1006 (1967) 24

Stella v. *Graham-Paige Motors Corp.*, 104 F. Supp. 957 (S.D.N.Y. 1952) 17, 26, 27, 28, 29

Stella v. *Graham-Paige Motors Corp.*, 232 F.2d 299 (2 Cir.), *cert. denied*, 352 U. S. 831 (1956) 25, 26, 30, 31

Willheim v. *Murchison*, 342 F.2d 33 (2 Cir.), *cert. den.*, 382 U. S. 840 (1965) 34

Statutes and Regulations

Securities Act of 1933, 15 U.S.C. § 77e 3

Securities Exchange Act of 1934, 15 U.S.C. *et seq.*

§ 3(a), 15 U.S.C. § 78c(a) 31

§ 9, 15 U.S.C. § 78i 12

§ 10, 15 U.S.C. § 78j 12

§ 16(b), 15 U.S.C. § 78p(b) 2, 5, 6

§ 16(c), 15 U.S.C. § 78p(c) 11

Securities and Exchange Commission Rule 409, 17 C.F.R. § 230.409 3

Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 22

Securities and Exchange Commission Rule 12b-2, 17 C.F.R. § 240.12b-2 34

Legislative History

PAGE

Hearings Before the Senate Committee on Banking and Currency, 73d Cong., 1st and 2d Sess. 7, 8, 11, 13

Hearings Before the House Committee on Interstate and Foreign Commerce on H.R. 7852 and H.R. 8720, 73d Cong., 2d Sess. 7

H. Rep. No. 1383, 73d Cong., 2d Sess. 11

S. Rep. No. 792, 73d Cong., 2d Sess. 9, 10, 12, 13

S. Rep. No. 1455, 73d Cong., 2d Sess. 12

Miscellaneous

Cook and Feldman, *Inside Trading Under the Securities Exchange Act*, 66 Harv. L. Rev. 385 (1953) 28

2 Loss, *Securities Regulation* (2d ed. 1961) 28, 34

Lowenfels, *Section 16(b): A New Trend in Regulating Insider Trading*, 54 Cornell L. Q. 45 (1968) 22

Munter, *Section 16(b) of the Securities Exchange Act of 1934: An Alternative to "Burning Down the Barn in order to Kill the Rats,"* 52 Cornell L. Q. 69 (1966) 28

Note, 84 Harv. L. Rev. 1012 (1971) 28, 35

Note, 70 Harv. L. Rev. 1312 (1957) 14, 28

Note, 44 Marq. L. Rev. 64 (1960) 28

Note, *Short-Swing Profits and the Ten Percent Rule*, 9 Stan. L. Rev. 582 (1967) 28

Note, *Stock Exchanges Pursuant to Corporate Consolidation; A Section 16(b) "Purchase or Sale"?*, 117 U. Pa. L. Rev. 1034 (1969) 21

Painter, *Federal Regulation of Insider Trading* (1938) 28

IN THE

Supreme Court of the United States

OCTOBER TERM 1971

RELIANCE ELECTRIC COMPANY,
Petitioner,

v.

EMERSON ELECTRIC COMPANY,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MOTION OF GULF & WESTERN INDUSTRIES, INC. FOR LEAVE TO FILE THE ACCOMPANYING BRIEF AS AMICUS CURIAE IN SUPPORT OF THE POSITION OF THE RESPONDENT

Gulf & Western Industries, Inc. (hereinafter "Gulf & Western") hereby respectfully moves for leave to file the accompanying brief *amicus curiae* in this case. Attorneys for respondent have indicated that they neither consent to nor oppose the motion. The consent of the attorneys for the petitioner was requested but refused.

THE DECISION BELOW

The opinion of the court of appeals (App. 170-182) is reported at 434 F.2d 918. The opinion of the district court (App. 157-165) is reported at 306 F. Supp. 588.

The court of appeals held that the exemption for more than ten percent beneficial owners set forth in the text of Section 16(b) of the Securities Exchange Act of 1934, 15

U.S.C. 78p(b): (1) does not exclude the transaction by which a person previously unrelated to the issuer corporation acquires more than ten percent of a class of the issuer's shares; and (2) does exclude the second sale where such beneficial owner reduces his holdings below ten percent, and then sells the remainder of such shares.

THE INTEREST OF GULF & WESTERN INDUSTRIES, INC.

The interest of Gulf & Western arises from the fact that it is engaged as defendant in an action presently pending in the United States District Court for the Northern District of Illinois, Eastern Division, entitled *Allis-Chalmers Mfg. Co.* v. *Gulf & Western Ind., Inc.*, No. 70 C 513. In that action recovery is sought pursuant to Section 16(b) for alleged profits made by Gulf & Western in shares of the common stock of the plaintiff, "Allis-Chalmers", in connection with its acquisition of such shares pursuant to an exchange offer, and subsequent disposition thereof.

A central issue in that action is whether the purchase by which one becomes a more than 10 percent beneficial owner must, in all circumstances, be included under Section 16(b), in light of the statutory exclusion, "This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or sale and purchase, of the security involved. . . ." In that action, Gulf & Western concededly had no prior relationship with the issuer corporation before its initial purchase, made a single purchase of 3,000,000 shares by the exchange offer, and such acquisition and exchange offer were made in connection with full prospectus disclosure about the affairs of both Allis-Chalmers and Gulf & Western, as required pursuant to regulations promulgated under

the Securities Act of 1933.* Because Gulf & Western's initial acquisition involved 3,000,000 shares, the stake involved in that issue is clearly very great.

QUESTIONS THAT MAY NOT ADEQUATELY BE PRESENTED BY THE PARTIES

In the instant case, petitioner has restricted its argument to the question of whether a more than ten percent beneficial owner may reduce the amount of "automatic" liability he may potentially suffer under Section 16(b) by selling part of his holdings to reduce those holdings below 10 percent, and by selling the remainder of his holdings when he no longer occupies the status of the class of persons subject to the statute. If the issues and analysis in this case were so limited, Gulf & Western might have no interest in participating in this matter as *amicus curiae*.

However, the Securities and Exchange Commission ("SEC") has filed a brief *amicus curiae* which treats both ends of the transactions in question, and directly brings into issue the full scope and meaning of the statutory exemption as applied to both the initial purchase and both subsequent sales. In this way, the SEC apparently seeks the direct or indirect adjudication of an issue which clearly would not be a principal area of respondent's argument herein, if indeed it is advanced by respondent at

* Since Gulf & Western offered, in part, its own securities for Allis-Chalmers shares, it was required to do so pursuant to a registation statement and prospectus under the Securities Act of 1933: see 15 U.S.C. § 77(e). It was also required to secure and include therein information concerning the affairs of Allis-Chalmers, pursuant to Instruction F of the General Instructions for Form S-1 and Rule 409 promulgated by the SEC. Because Gulf & Western agreed to pay the expenses of Allis-Chalmers in providing the required financial information, the prospectus contained extensive treatment of Allis-Chalmers. It is conceded in that case that the prospectus complied with the federal law obligation of providing complete disclosure of material information, not misleading by reason of misstatement or omission.

all. This is so because respondent did not seek a writ of certiorari with respect to the initial transaction issue, and, we are advised, will address only the arguments made by the petitioner.

These circumstances present the danger that analysis in this case may proceed without challenge having been made to the treatment of the larger issue presented by the SEC. If the SEC's attempt to inject that issue and its view thereof were accepted, it will result in the practical prejudgment of that issue in the action in which Gulf & Western is engaged. Such a result, without benefit of trial, argument or judgment in that case, would most unfairly prejudice the litigation there. It would be unfair to preclude the trial court in *Allis-Chalmers* from deciding that case on its own merits. To cast a shadow on important issues in that case, by reflection here on a matter which was not presented by the parties, but originates only in the zeal of a governmental volunteer, would be patently unjust. Such prejudice can be avoided if the Court does not allow itself to be drawn into the decision of an important issue which is neither before it at the instance of the parties, nor the subject of their respective arguments. To guard against the possibility that the SEC might persuade the Court to adjudicate issues not tendered by the parties, we have requested permission to present our view of the construction of the statutory exemption involved. In our submission the theories offered by the SEC are fundamentally defective and unsupported by the legislative history of Section 16(b).

We propose to confine our analysis solely to the question of the initial ten percent transaction. Insofar as this issue may be deemed to be involved, despite the fact that it was not a subject of a petition for a writ of certiorari, our position supports the interest of the respondent, and would be dispositive of the case, regardless of the arguments presented on the "sale" end of the transactions.

For the foregoing reasons, we respectfully urge that Gulf & Western's motion be granted so that this Court may be informed of the countervailing considerations if it should extend its examination beyond the issues tendered by the parties.

Respectfully submitted,

WHITNEY NORTH SEYMOUR
Counsel for Gulf & Western Industries, Inc.
One Battery Park Plaza
New York, New York 10004

BRIEF IN SUPPORT OF THE POSITION OF THE RESPONDENT

JURISDICTION

The judgment of the court of appeals (App. 183) was entered on November 12, 1970. The petition for a writ of certiorari was filed on February 9, 1971, and was granted on April 5, 1971 (401 U.S. 1008). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the purchase by which a person with no prior relationship with the issuer corporation acquires more than ten percent of any class of securities of the issuer must, in all circumstances, be included as a transaction within Section 16(b), despite the statutory exemption stating that Section 16(b) should "not be construed" to cover such a transaction.

STATEMENT

We accept, and will not repeat, the statements of the case set forth by the petitioner, the respondent, and the SEC as *amicus curiae*.

STATUTE INVOLVED

Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(b), provides in pertinent part:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, * * * shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

ARGUMENT

SECTION 16(b) ACCORDS DIFFERENT TREATMENT TO OFFICIAL INSIDERS (OFFICERS AND DIRECTORS) THAN TO LARGE SHAREHOLDERS OF THE CORPORATION, BASED UPON A DISTINCTION WHICH ATTRIBUTES TO THE FORMER NOT ONLY KNOWLEDGE OF INSIDE EVENTS, BUT ALSO A CAPACITY TO MANIPULATE THE AFFAIRS OF THE CORPORATION TO CREATE EVENTS WHICH WILL AFFECT THE MARKET VALUE OF THE STOCK, AND ATTRIBUTES TO THE LATTER MERE ACCESS TO INSIDE INFORMATION. UNLESS SUPPLEMENTED BY OTHER PROOF, THE TRANSACTION BY WHICH A PERSON WITHOUT A PRIOR RELATIONSHIP TO THE ISSUER CORPORATION ACQUIRES THE STATUTORILY PRESCRIBED PERCENTAGE OF SHARES IS AND SHOULD BE EXCLUDED FROM SECTION 16(b)'s OPERATION.

1. The legislative history of Section 16(b) supports the aforesaid distinction between official and non-official insiders.

The present Section 16(b) did not experience a smooth journey in the legislative process. The original form of the section, embodied as Section 15(b) of Senate Bill No. 2693[1] and H.R. No. 7852,[2] provided in relevant part as follows:

> "It shall be unlawful for any director, officer, or owner of securities, owning as of record and/or beneficially more than five per centum of any class of stock of any issuer, any security of which is registered on a national securities exchange—

---

1. Hearings Before the Senate Committee on Banking and Currency 73d Cong., 2d Sess. (1934), pp. 6556-6557 (hereinafter, "Senate Hearings").

2. Hearings Before House Committee on Interstate and Foreign Commerce on H.R. 7852 and H.R. 8720, 73d Cong., 2d Sess. (1934), p. 9 (hereinafter, "House Hearings").

> "(1) To purchase any such registered security with the intention or expectation of selling the same security within 6 months; and any profit made by such person on any transaction in such a registered security extending over a period of less than 6 months shall inure to and be recoverable by the issuer, irrespective of any intention or expectation on his part in entering into such transaction of holding the security purchased for a period exceeding 6 months."

No testimony was directed to the text of Section 16(b) in its present form during the legislative hearings, but was instead directed to the quoted text contained in the original bills. For reasons which will be explained below, the bills went through a number of changes in both houses, including changes relevant to the present problem.

The original form of the section contained no exemptive language. When the chief staff spokesman for the bill, Thomas G. Corcoran, appeared before the Senate Committee on Banking and Currency on February 27, 1934, two types of objections were raised by the Senate Committee members to the broad coverage of the bill.[3] The first was the advisability of having the bill operate against shareholders of the corporation who were not officers and directors. The following exchange occurred between Senator Kean and Mr. Corcoran (Senate Hearings, p. 6556):

> "Senator Kean. I think it is all right to apply it to a director or officer, but I think to require the ordinary investor—
>
> Mr. Corcoran. Five percent is a lot in a modern

3. Objections were also made to two omissions from coverage, later cured. The section was changed to permit the pairing of a sale followed by a purchase, (See Senate Hearings, p. 6557-8) and to correct an error making it appear that a director or officer would also have to hold 5% of the issuer's stock before he was subject to the statute. (See Senate Hearings, p. 6555)

corporation. Many corporations are controlled by 5 percent or 10 percent.

Senator Kean. They may own it or they may sell it. This applies to all corporations, and you are getting down to the point where you are interfering with the individual a good deal there. I agree with you with respect to the officers and directors.

Mr. Corcoran. A stockholder owning 5 percent is as much an insider as an officer or director. Whether he is a titular director or not, he normally is, as a practical matter of fact, a director.

Senator Kean. He might not be."

The second related to the general problem of the undesirable restrictions which might be placed upon fiduciaries in the administration of estates containing securities (Senate Hearings, p. 6558)—the problem to which the Brief of the SEC gives exclusive emphasis.

The staff draftsmen were apparently responsive to the second problem, but were unsympathetic to efforts to exclude shareholders from the statute's operation. Accordingly, a substitute Senate Bill No. 3420,[4] introduced on April 27, 1934 contained a provision giving generalized powers to the SEC to exempt transactions not comprehended within the purpose of the section, allowing room for the treatment of the problems of fiduciaries as well as other not immediately appreciable applications that might be undesired. And to meet the objections against making this automatic confiscation provision applicable to shareholders, the substitute bill raised the statutory ownership requirement from 5 percent of outstanding shares to more than 10 percent of such shares. This sequence makes clear that the provision giving the SEC such exemptive power was de-

4. Reprinted in Senate Report No. 792, 73d Cong., 2d Sess., p. 20 (1934).

signed to deal with, *inter alia*, the problems faced by fiduciaries, rather than, as now suggested by the SEC, that the 10 percent beneficial owner exemption was so designed.[5] For the latter provision was not included in any Senate draft.

On the other hand, the House draftsmen appeared more sympathetic to the problem of shareholders who did not become officers and directors, and in a revised bill (H.R. 8720, introduced on March 19, 1934) added not only a provision giving the SEC exemptive power, but also the exemption for 10 percent beneficial owners appearing in the statute as enacted. The House bill also added a preamble to the statute identifying its target not as the prevention of manipulation, but as the "unfair use of information" which "may have been obtained" by insiders by reason of a "relationship with the issuer."[6]

The significant difference between House and Senate attitudes toward this automatic recapture provision, reflected in part by its addition of the exemption for ten percent shareholders, is evidenced by subsequent events. Despite the additional exemptions contained in H.R. 8720, apparent hostility in the House to the automatic liability provisions resulted in the passage of a substitute bill, H.R. 9323, in-

---

5. The SEC concedes that it has never relied, directly or indirectly, on the exemption for ten percent beneficial owners to resolve problems arising from the administration of trusts by fiduciaries. SEC Brief, p. 31. The alternate suggestion of the SEC that the exemptive provision was designed to deal solely with involuntary changes in ownership is obviously unsound. There is no support for this in the legislative history, and courts have handled the general problem of volition on an entirely independent basis. See, *e.g.*, *Ferraiolo v. Newman*, 259 F. 2d 342, 344-45 nn. 2, 3 (6 Cir. 1958), *cert. denied*, 359 U. S. 927 (1959).

6. The court of appeals, apparently relying upon a law review article, erroneously believed that the statutory preamble had been first introduced by S. Bill 3420, set forth in S. Rep. 792, 73rd Cong., 2d Sess. (1934). See 434 F. 2d 926, n. 21.

troduced on April 25, 1934, which contained no provision for automatic recapture of profits by either officers, directors or shareholders. In the version passed by the House, Section 16 would merely have required the reporting of transactions by insiders and contained the prohibition against short sales by insiders now appearing in Section 16(c) (the "anti-Wiggin" subsection).[7]

Because of the disagreement between H.R. 9323 as passed and the proposed Senate amendment thereto, the matter was referred to a committee of conference, which reported a conference bill containing the text of Section 16(b) in its present form, including the preamble added by the House, and *both* the exemption for ten percent beneficial owners previously proposed by the House, and the provision allowing for SEC exemption of transactions not falling within the statutory purpose.

Section 16(b) had been presented, first to the congressional committees, and then by the committees to their respective branches as a whole, as a special tool to combat the unfair use of inside information in short-term "speculative swings"[8] and, by reason of the House amendment, is so identified in its preamble. Nevertheless, there was a related problem which went beyond the use of inside information, and that problem was the manipulation of the affairs of a corporation to cause it to engage in activities which would affect the value of its stock favorably to the trading insiders. Its prevention is less clearly a target of Section 16(b), and it appears to have been brought into consideration in a somewhat backdoor fashion.

The Senate Committee on Banking and Currency, which was commissioned in 1932 to investigate stock market prac-

7. House Report No. 1383 on H.R. 9323, 73d Cong. 2d Sess., p. 3, 24 (1934).

8. See Senate Hearings, p. 6557.

tices, concentrated its efforts on the large trading pools through which manipulators had sought to create false activity in the shares in which they were trading, often granting option interests to exchange members to encourage their cooperation in these and similar efforts.[9] These abuses were quite different from the abuses claimed by the spokesman to require the passage of Section 16(b) and were met by specific prohibitions in Section 9, and more generally, Section 10, of the 1934 Act. But when, after the 1934 Act had been passed, the Committee staff was called upon to report the evidence developed in its investigations, the staff writers of the Senate reports made derivative use of the materials developed in connection with the aforesaid manipulative practices, confusing to some extent the issues of use of inside information and that of manipulation of corporate affairs.[10]

Although these materials without exception showed officers and directors rather than shareholders directing these abusive trading practices,[11] it is nevertheless true that at least one prior report reflected the same confusion between informational and manipulative abuses. Thus, one example set forth in Senate Report 792, which accompanied Senate Bill 3420, suggested that certain directors participating in a trading pool had engaged in the manipulation of dividends to benefit the trading pool (S. Rep. 792, p. 9). On the basis of this legislative history, it might be argued that

---

9. See Senate Report No. 1455, 73 Cong., 2d Sess., pp. 1-4 (1934).

10. See Senate Report No. 1455, entitled "Stock Exchange Practices," 73d Congress, 2d Sess. (1934); compare pp. 29-54 with pp. 55-68. This report was issued on June 16, 1934, after the conference bill was reported and passed. Although it is instructive as to the investigations conducted by the Pecorra committee, it was not a report which may properly be used to evidence the intent of Congress in the passage of the bill since it followed its passage and purports to represent only the views of the Senate Committee.

11. *Ibid.*

this type of manipulative practice was also an object of S. Bill 3420. And since S. Bill 3420 made no distinction between official and non-official insiders, it could be claimed that both official and non-official insiders alike were presumed to have had manipulative ability as opposed to mere informational access. However, S. Bill 3420 did not become law. Rather, the conference bill which was passed by both houses and which reflected the narrower position of the House, did specifically give different treatment to official and non-official "insiders". It is on the basis of this distinction in imputing manipulative ability that the statutory exemption has been, and most plausibly can be, explained. *Adler* v. *Klawans,* 267 F.2d 840 (2 Cir. 1959).

Section 16(b) was presented to the Congress as a device designed to reach directors, officers, and large shareholders "speculating . . . on the basis of information not available to others" and more specifically, trading in the stocks of their own companies "with the benefit of *advance information.*"[12] Spokesmen in committees, testifying with respect to Senate Bill No. 2693 (the original bill), described its target as instances where insiders bought stock with inside foreknowledge of information which, when released, would cause a rise in the value of the stock, and then sold upon the rise; and the reverse situation, where insiders sold stock with foreknowledge of information which would cause a decline in the value of the stock, and repurchased when the decline occurred.[13] In the text of the original bill, the target was the purchase of a security "with the intention or expectation" existing at the time or the purchase "of selling the same security within six months", although, of course, such expectation need not be proved.

---

12. Senate Report No. 792, 73d Cong., 2d Sess., p. 9 (1934). (Emphasis added.)

13. Senate Hearings, pp. 6557-6558.

Obviously, unless inside information can be presumed to exist at the time the initial transaction is effected, there is no statutory basis for presuming an "intention or expectation" later to dispose of the shares. And because there is no statutory "relationship with the issuer" until the requisite ten percent purchase has been made, there is no basis for presuming it was made on the basis of inside information. This has been noted by the Second Circuit in *Newmark* v. *R.K.O. General, Inc.*, 425 F.2d 348, 356 (2d Cir.), *cert. denied*, 400 U.S. 854 (1970), as follows:

> "[T]his presumption would not justify the conclusion that one who purchases a quantity of shares which makes him a ten percent beneficial owner has done so on the basis of inside information . . ."

In short, if the only circumstances in a case were that the ten percent beneficial owner had become such in a transaction which he entered "blind"—that is, without the "relationship with the issuer" which is a prerequisite to the presumption of inside information—he would be in no position to undertake the "speculative short swing" at which the statute was aimed, and accordingly there should be no "automatic" liability. Note, 70 Harv. L. Rev. 1312, 1313 (1957).

Because there is no exemption in the statute for officers and directors, it follows that there must be a difference between the presumed capacities of official and shareholder insiders to support a difference in treatment. This was explored by the present Chief Justice[14] writing for a unanimous court in *Adler* v. *Klawans, supra*, 267 F.2d 840. There the defendant bought shares, became a director of the corporation, and then sold his shares within six months of purchase. Upon becoming a director he successfully

14. Sitting by designation pursuant to 28 U.S.C. § 291(a).

moved for the declaration of an unusual cash and stock dividend, and in addition he moved for the repurchase by the issuer corporation of some of its outstanding shares. Both acts would have had the effect of raising and supporting the price of the stock. Immediately thereafter, the director began selling his own shares. In holding the director liable, although he had bought the subject shares before he became director, the court based its holding upon very distinct reasoning:

> "Our primary holding simply gives effect to the statutory mandate which presupposes that, at some moment before making a sale of stock, the insider was in an *official position* which he *could have used to influence* the sale price. (*Supra,* 267 F.2d 845.)" (Emphasis added to emphasis in original) 267 F.2d at 848.

The court, in short, gave effect to the residual target of Section 16(b)—the manipulation of corporate affairs to produce a change in the value of the stock. But in extending the statute to this less certain target, the court drew a clear line between officers and directors on one hand and ten percent beneficial owners on the other:

> "There is, of course, a logical and practical basis for distinction. Generally, although there are important exceptions in certain circumstances, officers and directors have more ready access to the intimate business secrets of corporations and factors which can affect the real and ultimately the market value of stock than does even so large a stockholder as a '10% beneficial owner.' This is not to discount the potential influence of the [mere shareholder] but simply to acknowledge the basis for the different treatment accorded them by Congress. Moreover, a director or officer can usually *stimulate more directly*

> *actions which affect stock values* and might have knowledge of factors which might depress values. . . . Beyond doubt it was considerations of this character which led Congress to make a provision concerning 10% owners which was not made with respect to officers and directors. It is found in the following language: [quoting the statutory exemption]." (Emphasis added) *Adler* v. *Klawans, supra,* 267 F.2d at 845.

We believe that this distinction accurately reflects the compromise finally reached by the House and Senate conferees with respect to the treatment of shareholders. Clearly, it is one thing to presume that a large shareholder has sufficient footing with management to receive reports of confidential information, and it is quite another to presume that a statutory beneficial owner can manipulate corporate policy. Indeed, the facts of the instant case, if nothing else, negative that type of unwarranted assumption. And the proposition may be put in more general terms. An officer or director has a direct and inherent responsibility to exert influence upon the conduct of his company's affairs and to apprise himself of all relevant information. He is expected to use these for the corporation's benefit, but as the legislative history of the 1934 Act demonstrates, he may not. A shareholder, on the other hand, clearly has no such function, and may in fact *never* have any access, informational or otherwise, to the company's management.

This distinction between the presumed manipulative abilities of official and non-official insiders explains the statutory exemption. For if one possesses manipulative ability, he can create a profit even though his purchase of shares was made without inside information. Thus, directors and officers may be charged for such transactions, whereas, under the exemptive language, a shareholder may not—

unless, as explored in Point 3, *infra,* other facts give reason for deciding otherwise. Resolution of this problem on the basis of this distinction yields logical results. As demonstrated in the following section, the theories proposed by the SEC do not.

2. The reasons offered by the SEC for charging the transaction by which one becomes a ten percent beneficial owner are unsound.

At pages 23 to 25 of its brief the SEC suggests three reasons for charging the initial ten percent transaction. Each is fundamentally deficient.

First, it is suggested that a person who becomes a ten beneficial owner by the purchase of a large block of shares may have obtained inside information prior to the purchase through negotiations for the purchase. This theory is contrary to the structure of the statute itself, which conditions a presumption of inside information upon the existence of a statutorily defined "relationship with the issuer." Such a theory has twice been rejected by the Second Circuit.[15] And it seeks impermissibly to force additional presumptions onto those already in the statute. See *Blau* v. *Lehman,* 368 U.S. 403, 413-414 (1962). There is

15. Participating as *amicus* in *Stella* v. *Graham-Paige Motors Corp.,* 104 F. Supp. 957 (S.D.N.Y. 1952), *aff'd in part and remanded in part,* 232 F. 2d 299 (2 Cir.), *cert. denied,* 352 U.S. 831 (1956), the SEC urged the same "information before ownership" argument as a basis for liability. Memorandum for the Securities and Exchange Commission, March 1952, pp. 5-6. Neither the district court nor the circuit court would accept this ground, basing liability in that case on the problem of repetitive inside ownership. See 104 F. Supp. at 957; 232 F. 2d at 300-301. This case is discussed *infra* at p. 26. In *Newmark* v. *R.K.O. General, Inc., supra,* the same court noted that the premises of Section 16(b) will not justify a presumption that one who purchases more than ten percent of an issuer's outstanding shares has done so on the basis of inside information. 425 F. 2d 348, 356.

nothing in Section 16(b) that requires or invites a court to presume that a prospective purchaser of shares has bargained with the issuer either for the shares or for confidential disclosures, when he can as easily acquire shares on the open market, or as in this case through a nationally publicized tender offer, or as in the Gulf & Western litigation, through a national exchange offer made by prospectus.

Second, the SEC urges that a person may purchase a large block of shares with the intent to engage in manipulative practices to raise the value of the shares after he has become an insider. As the aforesaid legislative history set forth in Point 1, *supra,* demonstrates, Section 16(b) was not primarily designed to counter manipulation, and to the questionable extent that it does so, it attaches "automatic" liability only to officers and directors, not making an arbitrary presumption of manipulative ability in the case of ten percent beneficial owners. *Adler* v. *Klawans, supra.*

Third, it is urged that regardless of a purchaser's intent, he could, subsequent to the purchase, manipulate the affairs of the corporation and obtain inside information. Since intent is irrelevant under Section 16(b), this third suggestion is the same as the second, insofar as claimed manipulation is concerned, and does not present an additionl argument.

To the extent that the SEC's "third" reason contains the suggestion that Section 16(b) should apply because a ten percent purchaser could theoretically obtain information *after* the purchase which he could use in selling the stock, it raises the substantial question of whether presumed use of after-acquired information—that is, information relevant solely to one-half of an alleged short-swing transaction—is an abuse contemplated by Section 16(b). This

same theory was suggested in *dictum,* in *Newmark* v. *R.K.O. General Corp., supra,* 425 F.2d at 356, where it was argued that "the presumed access to such [subsequent] information resulting from this purchase provides him with an opportunity, not available to the investing public, to sell his shares at the moment most advantageous to him."

We submit that application of Section 16(b) on the after-acquired information theory is a clear and impermissible extension of the statute beyond its purpose, and that the theory is demonstrably unsound.

First, it is clearly beyond the scope of the statute which the Congress intended to enact, and this is evidenced by the aforesaid legislative history. If liability is imposed merely upon the possibility of after-acquired information, then the aim is no longer to reach the trader who had a present "intention or expectation" at the time of the purchase to dispose of the securities within 6 months or to attack those who engage in a speculative short swing "*with advance information.*" It is an extension of the statutory purpose. Yet the clear teaching of this Court in the only case in which it has previously considered Section 16(b) was that so arbitrary a mechanism should not be expanded beyond the narrow range of its application. *Blau* v. *Lehman, supra,* 368 U.S. 403, 411-412.

Second and, we submit, conclusive is that such a theory yields analytically unsupportable results. Its premise is that after a purchaser has become a ten percent owner, his presumed access to inside information will allow him to sell at a time and price more "advantageous" than that available to an "outside" shareholder—*i.e.*, in advance of a less favorable price for the stock due to negative (or static) prospects for the corporation's business not publicly known at the time of the sale. If the insider does so sell on the basis of his presumed information, his advantage

or "profit" over an outside investor is that he unfairly saves to himself the difference between his sale price and the price he would have received if he, like any other member of the public, had held his stock and disposed of it at some less favorable time. In other words, the unfair "profit" is his actual sale price minus some other and lesser sale price on the stock. But Section 16(b) simply cannot measure such a profit. For if Section 16(b) were applied, the insider would be charged instead with the difference between his prior purchase price and his sale price.

This is a result which bears *no relationship* whatsoever to the insider's profit, if any, by the use of inside information. This is demonstrated in the margin.[16] The defendant will consistently be charged with either less than or more than the profit resulting from his presumed use of inside information. Such a result is unsupportable, not merely because it has no relationship to the insider's possible use of inside information, but further because there is no possibility of such a relationship, except in the improbable coincidence

---

16. The results of the aforesaid theory are readily demonstrated by two hypothetical cases which assume *arguendo* actual use of inside information, within the range of the prototype suggested.

X, having no prior relationship to the corporation, buys more than 10% of its shares in the presumptively innocent transaction at $20 per share. In the succeeding months the stock rises to $50. In the fifth month he learns on an "inside basis" that earnings will be lower than predicted and sells his shares at $50. When the news is announced, the stock drops to $45. Although he has clearly gained an unfair advantage of $5 over a public investor, the SEC's theory would charge him with a $30 advantage. Yet $25 of the increment has *nothing* to do with any use of inside information, actual or potential.

Or take the converse situation: X's initial and presumptively innocent purchase is made at $22 per share. In the succeeding months the price rises to $25 per share. In the fifth month X learns that the corporation's main product line has a serious safety defect, and sells his shares at $25. When the news is announced the stock drops to $10 per share. Although X has gained an unfair advantage of $15 over a public investor, the SEC's theory will charge him with only $3.

that the increase in value of the securities during the insider's holding period precisely equalled the difference in sale prices. The theory, in short, yields an absurd result—and such a result should not be ascribed to the 73rd Congress as having been intended by it.

What is shown quite clearly is that Section 16(b) is *inherently structured* so that it can measure "profit" only from the date of purchase to the date of sale, or vice-versa. This alone indicates that the purchase itself must be infected with presumable abuse. *Otherwise both the price of purchase and the very fact that there was a recent purchase are stripped of relevance.*

This problem was the subject of treatment in a recent commentary, which illustrates the logical defect of the after-acquired information theory.

> "[I]t appears undesirable to apply section 16(b) to a situation where there is no possibility the insider could have had inside information when he made his original purchase (or sale). *Cf. Stella* v. *Graham-Paige Motors Corp., supra* (Hincks, J., dissenting). In such situations, although the later sale (purchase) may be made on the basis of inside information, *the unfairness is independent of whether the two transactions were made in conjunction with each other* as section 16(b), which speaks in terms of 'purchase and sale' and 'sale and purchase,' seems implicitly intended to require. *It is actually a single-transaction abuse where Section 16(b) is brought into play only because of the mere happenstance that the original purchase (sale) took place less than six months earlier.* It would be preferable to treat such situations under the general anti-fraud provisions of the Securities Exchange Act, § 10(b), 15 U.S.C. §78j(b) (1964) and Rule 10b-5 thereunder, 17 C.F.R. §240.10b-5 (1968)." (Emphasis added).

Stock Exchanges Pursuant To Corporate Consolidation: A Section 16(b) "Purchase or Sale"?, 117 U. Pa. L. Rev. 1034, 1042 n. 39 (1969).

And in *Blau* v. *Lamb*, 363 F.2d 507, 522-23 n. 22 (2 Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967), the Second Circuit, responding to an argument that because an insider could engineer a high dividend and then convert his stock to obtain it, a conversion should be treated as a chargeable transaction under Section 16(b), said:

> "The difficulty with this argument is that the danger exists independently of short-term trading by controlling insiders in their issuer's stock. For example, in the stated hypothetical, precisely the same opportunity for abuse would exist if the insider had held the convertible security for more than six months."

Precisely the same difficulty exists with the after-acquired information theory.

Under the after-acquired information theory the only conceivable abuse lies between two possible sale prices—a "profit" which Section 16(b) is not capable of measuring. It contemplates, in short, an alleged wrong with which Section 16(b) was not meant to deal, but for which Section 10 and Rule 10b-5 promulgated thereunder were.[17] "[O]ther

17. If an insider, after the presumptively innocent first transaction, thereafter acquired inside information—that is, learned news affecting the value of the stock—and sold at a time before the news was publicly released, plaintiff's task in remedying this abuse is heavily aided by statute. Even though the insider is not liable under Section 16(b), he must still report both his purchase and sale under Section 16(a). Reports filed under 16(a) are published regularly in financial newspapers. The potential plaintiff will immediately be aware of the transaction. Moreover, in the most likely situation there will be a specific event which, when announced, will cause a devaluation of the stock. In this circumstance both the private plaintiff and the SEC will know of both such event and the insider's transaction, laying the foundation for a very good case pursuant to Rule 10b-5 promulgated under the Act. The application of Rule 10b-5 obviously *will* yield profit liability related to the possible abuse. See generally Lowenfels, *Section 16(b): A New Trend in Regulating Insider Trading*, 54 Cornell L. Q. 45, 61-64 (1968).

remedies are then available but only on proof of actual wrongdoing."[18]

The SEC nevertheless urges that possible use of after-acquired information should support automatic liability because it claims that the preamble to the statute, designating its target as the "unfair use of information," suggests a "broad" application (SEC Brief, p. 25). As indicated at pages 10-11, *supra,* the legislative history suggests that the preamble was inserted by the House to narrow the scope of the statute. Thus, in a related context, the Ninth Circuit noted:

> "As section 16(b) itself states, its general purpose is to preclude the 'unfair use of information which may have been obtained by' corporate insiders, trading in securities of their corporation. But Congress did not seek to accomplish the whole of this purpose by section 16(b) alone. *Section 16(b) creates a special remedy, applicable only in a limited situation.*" (Emphasis added.) *Blau* v. *Max Factor & Co., supra,* 342 F.2d 304, 307.

The third defect in the after-acquired information theory is that its rationale does not relate in scope to the statutory exclusion it purports to explain. For example, if the purchaser had acquired a small number of shares before its ten percent purchase, and later disposed of these same shares along with the shares acquired in the ten percent purchase, it would be universally conceded that no claim could be made that the sale of the earlier acquired shares should be chargeable under Section 16(b).[19]

---

18. *Blau v. Max Factor Co.,* 342 F. 2d 304, 307 (9 Cir.); *cert. denied,* 382 U.S. 892 (1965).

19. See *Adler v. Klawans, supra.*

But under the after-acquired information theory, those shares are analytically identical to the shares acquired in the ten percent purchase, for the supposed after-acquired information would be equally relevant to their disposition. In short, the after-acquired information theory cannot be the rationale for including the initial transaction, for it would reach transactions which are concededly excluded by the statutory exemption, and therefore the theory obviously does not comport with the operation of the very statutory exemption which it purports to explain.

3. The rule should be that the transaction by which a person acquires more than 10 percent of a corporation's outstanding shares may or may not be charged under Section 16(b), depending upon whether the operative facts show the reasonable possibility of an abuse which the statute was designed to remedy.

Although Section 16(b) has been the victim of overly broad decisional language, in the past decade the courts of appeal and district courts have taken pains to avoid the overkill that might have resulted from thoughtless adherence to the language of older cases, without, however, diluting the true purpose of the statute.[20] Thus, for ex-

---

20. See, *e.g., Chemical Fund, Inc.* v. *Xerox, Inc.*, 377 F.2d 107, esp. 111n. 7 (2 Cir. 1967); *Pettys* v. *Butler*, 367 F.2d 528 (8 Cir. 1966), *cert. denied*, 385 U.S. 1006 (1967); *Ferraiolo* v. *Newman*, 259 F.2d 342 (6 Cir. 1958), *cert. denied*, 359 U.S. 927 (1959); *Cf. Mueller* v. *Korholt*, 1971 CCH Fed. Sec. L. Rep. ¶93,222, p. 91,404 (7 Cir. 1971); *Alloys Unlimited* v. *Gilbert*, 319 F. Supp. 617, 619 (S.D.N.Y. 1970).

ample, in *Blau* v. *Lamb, supra,* 363 F.2d 507, 517-519. Judge Waterman carefully noted that the dogmatic language appearing in *Park & Tilford, Inc.* v. *Schulte,* 160 F.2d 984 (2 Cir.), *cert. denied,* 332 U.S. 761 (1947), went unnecessarily beyond the needs of that case, while the actual decisions of the circuit and district courts reflected an analytical approach to the questions presented by Section 16(b). The same problem of overly broad decisional language has, to date, hindered analysis of the exemptive clause under consideration.

Contrary to the recital set forth in the SEC's Brief at p. 21, the question of whether the exemptive clause applies to the transaction by which a purchaser acquires more than ten percent of a class of shares has been raised as a defense by a Section 16(b) defendant in only three cases: *Stella* v. *Graham-Paige Motors Corporation,* 232 F.2d 299 (2 Cir.), *cert. denied,* 352 U.S. 831 (1956) (defense denied); *Allis-Chalmers Mfg. Co.* v. *Gulf & Western Industries, Inc.,* No. 70-C-513 (N.D. Ill.) (motion to strike defense denied); *Arkansas Louisiana Gas Co.* v. *W. R. Stephens Investment Co.,* 141 F. Supp. 841 (W.D. Ark. 1956) (defense allowed). The issue was unnecessarily treated in *dictum*[21] in *Newmark* v. *R.K.O. General, Inc., supra,* 425 F.2d at 355-356, and in *Abrams* v. *Occidental Petroleum Corp.,* 323 F. Supp. 570, 579 (S.D.N.Y.), *appeal argued and decision pending,* the issue was not raised by the defendant.[22] Every other case cited by the SEC either contains no reference to the problem or mentions the problem in passing *dictum.* And with two

21. See pp. 29-30, *infra.*

22. See Reply Brief For Defendant-Appellant, *Abrams* v. *Occidental Petroleum Corp.,* Nos. 71-1273-4-5-6 (2 Cir.), pp. 30-33.

exceptions, every case touching upon the problem was a case decided by a court within the Second Circuit, which is bound by the rule laid down in *Stella* v. *Graham-Paige Motors Corp., supra.*

These two exceptions, significantly, are cases where the defendants were not mere shareholders, but officers and directors. *Bershad* v. *McDonough,* 428 F.2d 693 (7 Cir. 1970) (defendants were a director and his wife whose joint holdings controlled the corporation); *Gold* v. *Scurlock,* CCH Fed. Sec. L. Rep. ¶93,021 at 90,770-90,771 (E.D. Va. 1971) (defendants were officers and directors in the corporation involved in the merger in which the shares "purchased" were received). In short, prior to the decision of the court below, there was only one court of appeals apparently committed to a rule which, at least in verbiage, required the inclusion of the initial ten percent transaction.

The difficulty with *Stella* v. *Graham-Paige Motors Corp., supra,* is that it, like *Park & Tilford, Inc.* v. *Schulte, supra,* was a case properly decided but done so in unnecessarily broad terms. The basis for the decision was expressly to deal with the problem of *repetitive* inside association,[23] in circumstances which gave compelling indications of access to inside information *before* the "initial purchase" so charged. In fact, the transaction was defendant's second, not first, inside association with the issuer corporation ("Kaiser-Frazer").

The purchase in question occurred in February, 1947.[24] Kaiser-Frazer had been formed in 1945, only two years

23. 104 F. Supp. at 959. The Second Circuit, in affirming, merely adopted the reasoning of the district court without discussion. 232 F.2d at 300-301.

24. The following facts are recited at 104 F. Supp. 957, 958.

before that date, and fully half of its shares were acquired by the defendant, the other half by interests controlled by Henry J. Kaiser. Thereafter the relationship of defendant "Graham-Paige" and the issuer continued, and defendant's massive holdings were reduced not by any affirmative disconnection between the two, but by the passive dilution of the percentage of its holdings due to further public offerings of stock. The first offering in September, 1945, reduced defendant's holdings to 11.34%. In January, 1946, an additional offering was made and defendant's holdings were reduced to 6.25%. During the same period, the holdings of the co-founder Kaiser were reduced to 9.25% of the shares outstanding, Kaiser having made several purchases in the interim. At the time of its February, 1947 purchase, defendant still held over 6.25% of Kaiser-Frazer's shares, and that purchase increased its holdings to 21%. Not only was there a continuing relationship, but the purchase of February, 1947 was that of an "outsider" only in form. It was uncontradicted that the purchase was:

> "in pursuance of [a prior] agreement under which these shares were placed in the voting trust of which Kaiser and Joseph W. Frazer, an officer of Graham-Paige, were the voting trustees."[25]

Thus, the purchase was in pursuance of a private agreement between the defendant and the co-organizer, whose combined holdings before the purchase amounted to 15.75% of the corporation's shares, and whose combined holdings, according to the prepurchase agreement, were to be placed in a voting trust after the purchase had been effected.

It should be noted that the defendant never argued that under the facts of the *Stella* case, Section 16(b) should not reasonably apply, but merely rested on the technical argument, that in light of the proviso noted, Section 16(b) could

---

25. *Ibid.*

never apply to an initial transaction, no matter what the factual circumstances.[26]

Using the facts of *recurrent* "inside" ownership in the case before it as a model, the district court in *Stella* posed a hypothetical situation which led it incorrectly to a rationale that Section 16(b) *always* includes the initial transaction. It believed that if Section 16(b) could not apply to a holder of shares who did not own more than ten percent before a transaction, then:

> "It would be possible for a person to purchase a large block of stock, sell it out until his ownership was reduced to less than 10%, and then repeat the process, ad infinitum."

104 F. Supp. 957, 959. The difficulty with such a theory[27] is that it has no application to a case where there has been no repetitive "inside" status. *Cessante ratione legis, cessate et ipsa lex.* In addition, it is clear that both on the facts

---

26. The formulation of the issue in the *Stella* case, and the absolutist theories upon which the parties, the majority, and the dissent therein proceeded obviously reflected the state of Section 16(b) analysis at that time, which was referred to as a "crude rule of thumb" approach. Since that time, in a number of cases cited throughout this brief, courts have resolved problematical areas of coverage on the basis of whether the peculiar facts allowed for the type of abuse at which the statute was directed. See, *e.g., Blau* v. *Lamb, supra,* 363 F.2d at 517-520 and cases cited *supra,* n. 20.

27. Authorities supporting the holding in *Stella* are 2 Loss, *Securities Regulation* 1060 (2d ed. 1961); Cook & Feldman, *Insider Trading Under the Securities Exchange Act,* 66 Harv. L. Rev. 612, 631-632 (1953); both of which rely upon the hypothetical problem set forth in the text.

Other commentators were quick to point out that the rationale of the hypothetical posed by the district court in *Stella* was not sufficient to justify an absolute rule. *See* Munter, *Section 16(b) of the Securities Exchange Act of 1934: An Alternative to Burning Down the Barn in Order to Kill the Rats,* 52 Cornell L. Q. 69, 75 (1966), *and see* Note, 70 Harv. L. Rev. 1312, 1313 (1957), approving the result in *Stella,* but observing that the court reached an unreasonably broad statement of application of the statute, beyond the needs of the hypothetical; see also Painter, *Federal Regulation of Insider Trading* (1938), pp. 41-42; Note, 84 Harv. L. Rev. 1012, 1022-3, n. 30 (1971); Note, *Short-Swing Profits and the Ten Percent Rule,* 9 Stan. L. Rev. 582, 587 (1967); Note, 44 Marq L. Rev. 64-65 (1960).

in *Stella* and on the rationale developed on the basis of the hypothetical, the underlying theory for charging the initial transaction was the probability, based on special facts, that an inside relationship existed *before* the transaction was effected.

Following the decision in *Stella,* commentators indicated that the rationale on which the court had imposed liability was insufficiently broad to justify charging the initial ten percent transaction in every case.[28] The Second Circuit apparently noted the defect. When the issue next arose, in *Newmark* v. *RKO General, Inc., supra,* the court merely cited, but did not repeat, the rationale of *Stella.* In language that was not related to the problem posed by the facts of *Newmark,* and which was clearly *dictum,* the court set forth the after-acquired information theory noted and discussed at pp. 19-24 *supra.* See 425 F.2d at 355-356.

The *Newmark* case, however, in no way involved the exploitation of after-acquired information. Rather, both the court of appeals and the district court explicitly found that the defendant "RKO" in fact had and used inside information before it purchased the shares involved. This information concerned a proposed merger between an airline it controlled ("Frontier") and another airline ("Central"). RKO contracted to purchase the Central shares involved before such information had been made public (249 F. Supp. 351). The circuit court found that:

> "RKO's contract to purchase Central shares is a classic example of trading while in the possession of information unavailable to the general public." 425 F.2d at 353.

In addition, the court expressly held that RKO had become a beneficial owner of more than ten percent of

28. See preceeding footnote.

Central's common stock *before* it purchased Central shares. 425 F.2d at 356. Before it took the investment risk of purchasing the Central shares, RKO had contracted to purchase such shares at a fixed price under an agreement which not only insured that the issuer, Central, would be managed in RKO's interest and required controlling Central shareholders to vote for the merger, but also in effect gave RKO the right to abandon the merger and the purchase of the shares if the merger turned out to be a less lucrative prospect than RKO desired. 425 F.2d at 353-354.

Thus it is appropriate to characterize as "dictum" the statement in the *Newmark* case as to the permissibility of attaching a later sale to a presumptively innocent initial purchase on the basis of the exploitation of after-acquired information, for the language had no bearing on the case then before this Court. There was no innocent initial transaction involved under the *Newmark* facts. Rather the case before the court was an archetypal example of an insider, with presumable and actual foreknowledge before its actual purchase, making that purchase with a view toward later disposition in a merger over which it retained control.

Thus, neither *Stella* nor *Newmark* provides any basis for the automatic inclusion of and extraction of profits from a transaction which results in an outsider becoming a more than ten percent beneficial owner. In the only case in which the issue arose in circumstances devoid of the countervailing facts which existed in the two Second Circuit cases, the court refused to charge the initial ten percent transaction. *Arkansas Louisiana Gas Co.* v. *W. R. Stephens Invest. Co., supra,* 141 F. Supp. 841, 847.

We do not seek or propose an absolute rule which would *always* exclude the initial transaction (as proposed by

Hincks, J., dissenting in *Stella* v. *Graham Paige Motors Co., supra,* 232 F.2d 299, 302-305). We do oppose a rule which, regardless of whether the purpose of the statute would be served, would *always* include the initial transaction. Liability should properly be found in cases of repetitive ownership (*Stella*), simply because the danger that the statute could otherwise be subverted is too great. And liability may properly be found in a case where the defendant, also as in *Stella,* had substantially an insider's relationship before the transaction in question. Equally sound in result is *Newmark* v. *RKO General, Inc.,* where the defendant not only purchased on the basis of inside information, but acquired a right to buy the shares before taking the investment risk of doing so, and then retained control over the merger—the event that would, if RKO so wished, lead to their disposition at a profit. Such a studied approach strikes at all the abuses for which Section 16(b) was designed. Equally important, it does not extend the range of the statute to situations to which it was not intended to apply.

We submit that such an approach has been prescribed by this Court in a closely analogous area. In *Blau* v. *Lehman, supra,* 368 U. S. 403, one Thomas, a partner of the investment house of Lehman Brothers ("Lehman") was a director of and thus an "insider" of Tidewater Associated Oil Company ("Tidewater"), having succeeded another Lehman partner on Tidewater's board. While Thomas was thus a director-insider, Lehman bought and sold Tidewater securities at a profit, Thomas disclaiming interest therein. Sections 3(a)9 and 3(a)7 of the 1934 Act permitted construing the word "director" in §16(b) as including a partnership such as Lehman,[29] although it did not so require. 368

29. See 286 F.2d at 794; 368 U. S. at 415.

U. S. at 410. Both plaintiff and the SEC argued that Lehman should be automatically treated as an insider and thus be held liable for all of the profits in Tidewater transactions, or alternatively that Thomas should be held liable for all of Lehman's profits. Their argument was characterized by the Court as follows:

> "Failure to do so, it is argued, will leave a large and unintended loophole in the statute—one substantially eliminating the great Wall Street trading firms from the statute's operation." (368 U. S. at 411).
>
> * * *
>
> "'[O]nly by holding the partner-director liable for the *entire* short-swing profits realized by his firm' it is urged, can 'an effective prophylactic to the stated statutory policy . . . be fully enforced'." (*Id.* at 413).

The SEC thus contended for a rule imposing liability upon Lehman without further proof. *Ibid.* This Court rejected these arguments, stating:

> "But liability under § 16(b) is to be determined neither by general partnership law nor by adding to the 'prophylactic' effect Congress itself clearly prescribed in § 16(b)." (*Id.* at 414).

Instead, this Court recognized the propriety of inquiry into the question of whether Lehman had in fact "deputized Thomas to represent its interests as a director of Tidewater," *id.* at 408, and affirmed the lower court's findings that Lehman had not so "deputized" Thomas.

Here, the statutory exemption, as noted by the court below, has repeatedly been termed "ambiguous" (434 F.2d at 922). We believe that the legislative history of the statute renders the purpose of the exemption far less "ambiguous"

and does so in respondent's favor. To the extent that uncertainty may remain in the construction of the exemption, *Blau* v. *Lehman, supra,* clearly holds that in areas in which coverage of Section 16(b) is questionable, coverage should not be arbitrarily resolved against a defendant as if it were not questionable. Rather, to the extent that there is flexibility in the language of the statute, it should be resolved in accordance with the operative facts present in each case. In this way, the objectives of Section 16(b) may be served without impermissibly adding to the basically sensible provisions of the statute.

For example, the court below believed that if it failed to draw an absolute rule including the first ten percent purchase, it would permit:

> "an initial purchase of as large a block of stock as 51 percent or more of a corporation's stock, followed by a sale any time within six months by the stockholders who obviously within that period could obtain such inside information and also could influence, manipulate or control corporate transactions." 434 F.2d at 924.

To the extent its reasoning rests on the after-acquired information theory, the unsound basis upon which that theory rests has been set forth in Point 2 *supra.* But the assertion that a shareholder would be able to effect a subsequent manipulation of the corporation's affairs is in conflict with both the distinction drawn by Congress and the reasoning in *Adler* v. *Klawans, supra.* To avoid this problem, the court below hypothesized a situation where the shareholder had acquired complete control—51% of outstanding shares. However, its rationale obviously does not cover cases where control and attendant manipulative ability are lacking.

The issue of control is an issue of fact, the resolution of which is a familiar problem regularly handled by the courts.[30] If it were demonstrated that a shareholder had gained control over the issuer corporation by reason of the purchase or purchases involved, his status would arguably be tantamount to that of an officer or director within the purview of Section 16(b), and would arguably make a defendant's position more difficult. Such supplemental proof is exactly the type of proof required by this Court's decision in *Blau* v. *Lehman, supra.* But in the absence of such proof, there is no basis for blurring the distinctions[31] drawn by Congress in the statute itself, nor for adding to the presumptions in the statute. Certainly, the fundamental fact of the instant case is that the respondent was wholly unable to exercise any control over the issuer's hostile management—who, in fact, sought to nullify the respondent's shareholdings by causing a merger with the petitioner herein.[32]

Other ambiguities exist in the application of the statute. For example, the question of whether transactions resulting from mergers, conversions, exchanges of assets, and similar transactions are "purchases"or "sales" within the purview of Section 16(b) provides no ready answer. These questions are being treated on the basis that a court should

---

30. See *e.g.*, Rule 12b-2 (§240.12b-1) issued under the Securities Exchange Act of 1934; *Willheim* v. *Murchison*, 342 F.2d 33, 38-39 (2 Cir.), *cert. denied* 382 U. S. 840 (1965) (Investment Company Act of 1940); 2 Loss, *Securities Regulation* 764-783 (2 ed. 1961.)

31. A distinction on the basis of control has been recognized by the Second Circuit in *Blau* v. *Lamb, supra,* 363 F.2d at 521 n. 19, as follows:

> "[A] noncontrolling 'insider' [shareholder] has the power to misuse inside information for speculative purposes by trading in light of the inside information to which he is privy. A 'controlling insider' also can manipulate corporate activity in order to create favorable short-swing trading situations."

32. No claim is made that any director nominated by Emerson was ever elected to Dodge's board of directors.

first inquire to determine whether a given set of transactions allowed for a possibility of abuse involved of the type at which the statute was aimed so that "purposeless harshness" may be avoided. See, *e.g., Blau* v. *Lamb, supra,* 363 F.2d 507, 519, and cases cited at n. 20, *supra.* Based upon a review of the *facts* of cases involving the statutory exemption for beneficial owners, it would appear that the application of that exemption has been resolved in a similar way. It is the overly broad decisional language that has created difficulties.

If the statutory exemption is unclear, it is an unjustifiable leap to hold that the initial ten percent transaction must always be included. If a wrong is alleged in these ambiguous circumstances, there must be some further proof of it. *Blau* v. *Lehman, supra;* Note, 84 Harv. L. Rev. 1012, 1022-3, n. 30 (1971). In the absence of such proof on the record of this case in connection with either the acquisition or disposition by respondent of its Dodge shares, it should not have been subjected to a harsh liability which does not serve the purposes of the statute.

CONCLUSION

The judgment of the court below should be affirmed insofar as it adjudged respondent not to be liable under Section 16(b), and, if the Court reaches the issue of the initial ten percent transaction, reversed to the extent that it adjudged liability against the respondent.

Respectfully submitted,

WHITNEY NORTH SEYMOUR
Counsel for Gulf & Western Industries, Inc.
One Battery Park Plaza
New York, New York 10004

Of Counsel:
JOHN A. GUZZETTA
BERNHARDT K. WRUBLE
Simpson Thacher & Bartlett

SUPREME COURT, U. S.

No. 70-79

In the Supreme Court of the United States

October Term, 1971

RELIANCE ELECTRIC COMPANY,

Petitioner,

vs.

EMERSON ELECTRIC COMPANY,

Respondent.

On Writ of Certiorari To The United States Court of Appeals For The Eighth Circuit

BRIEF FOR RESPONDENT

ALBERT E. JENNER, JR.
WESLEY G. HALL
LYNNE E. McNOWN
DOUGLAS C. NOHLGREN
135 South LaSalle Street
Chicago, Illinois 60603

R. H. McROBERTS
THOMAS C. WALSH
1600 Boatmen's Bank Building
St. Louis, Missouri 63102

Of Counsel:
JENNER & BLOCK

BRYAN, CAVE,
McPHEETERS & McROBERTS

UNITED STATES LAW PRINTING CO., CHICAGO, ILLINOIS 60618 (312) 525-6581

TABLE OF CONTENTS

	PAGE
STATUTE INVOLVED	1
QUESTION PRESENTED	2
STATEMENT OF THE CASE	3
SUMMARY OF ARGUMENT	8
ARGUMENT	11
I. SECTION 16(b) ON ITS FACE PROHIBITS ITS APPLICATION TO EMERSON'S SECOND SALE	11
A. The Parties, The SEC And Both Courts Below Are Unanimous That Emerson Was Not A 10% Owner At The Time Of The Second Sale. The Last Sentence Of §16(b) Clearly Exempts That Sale From Liability	11
B. Other Language In §16, And The Rules And Regulations Promulgated By The SEC, Buttress The Conclusion Of The Court Of Appeals	17
II. CONGRESS INTENTIONALLY LIMITED THE REACH OF §16(b)	18
III. NONE OF THE "PRINCIPLES OF CONSTRUCTION" URGED BY RELIANCE AND THE SEC SUPPORT THEIR REQUESTED RE-WRITING OF THE EXEMPTION PROVISION OF §16(b)	21

PAGE

A. Both Reliance And The SEC Would Have This Court Emasculate The Exemption Provision of §16(b) 21

B. Incantation Of "Remedial Purpose Of The Act" Does Not Justify Rewriting The Statute 26

1. Application Of The Unambiguous Exemption Provision To The Ordinary Cash Sale Here Does Not Require "Construction" 26

2. The Remedial Purposes Of The Act Do Not Support The Application Of §16(b) To The Facts Of This Case 31

3. The Court Should Decide This Case On Its Facts And The Law Applicable Thereto, And Not The Parade Of Horribles Hypothesized By Reliance And The SEC 33

C. The Arguments Of "Substance Over Form" And "Fiduciary Duty" Advanced By Reliance And The SEC Do Not Warrant A Rewriting Of The Exemption Provision To Cover Emerson's Second Sale 36

CONCLUSION 42

TABLE OF AUTHORITIES

Cases

PAGE

Abrams v. *Occidental Petroleum Corporation*, 323 F. Supp. 570 (S.D.N.Y. 1971), *appeal docketed*, Nos. 71-1273-4-5-6, 2d Cir. 23

Adler v. *Klawans*, 267 F.2d 840 (2d Cir. 1959) 12, 15, 18, 19, 36

American Bantam Car Co. v. *Commissioner*, 11 T.C. 397 (1948), *aff'd*, 177 F.2d 513 (3d Cir. 1949), *cert. denied*, 339 U.S. 920 (1950) 38

Anheuseur-Busch, Inc. v. *Helvering*, 40 B.T.A. 1100 (1939) *aff'd*, 115 F.2d 662 (8th Cir. 1940), *cert. denied*, 312 U.S. 699 (1941) 38

Bershad v. *McDonough*, 428 F.2d 693 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971) 20, 36, 37

Blau v. *Allen*, 163 F.Supp. 702 (S.D.N.Y. 1958) 15, 41

Blau v. *Lamb*, 363 F.2d 507 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967) 31

Blau v. *Lehman Brothers*, 368 U.S. 403 (1962) ..12, 20, 31, 34

Blau v. *Max Factor & Co.*, 342 F.2d 304 (9th Cir. 1965), *cert. denied*, 382 U.S. 892 (1965) 18, 31, 32

Chemical Fund, Inc. v. *Xerox Corp.*, 377 F.2d 107 (2d Cir. 1967) 29

City Nat. Bank v. *United States*, 207 F.2d 741 (10th Cir. 1953) 24

Commissioner v. *Gordon*, 391 U.S. 83 (1968) 38, 40

Electric Storage Battery Co. v. *Shimadzu*, 307 U.S. 5 (1939) 16

PAGE

Feder v. *Martin Marietta Corp.*, 406 F.2d 260 (2d Cir. 1969), *cert. denied*, 396 U.S. 1036 (1970) 14

Ferraiolo v. *Newman*, 259 F.2d 342 (6th Cir. 1958), *cert. denied*, 359 U.S. 925 (1959) 20

Gemsco, Inc. v. *Walling*, 324 U.S. 244 (1945) 25

Gregory v. *Helvering*, 293 U.S. 469 (1935) 37

In re Great Sweet Grass Oils, Ltd., 37 S.E.C. Reports 683 (1957), *aff'd*, 256 F.2d 893 (D.C. Cir. 1958) 39

King Enterprises, Inc. v. *United States*, 418 F.2d 511 (Ct.Cl. 1969) 38

Lockheed Aircraft Corp. v. *Campbell*, 110 F.Supp. 282 (S.D. Calif. 1953) 19

McBrien v. *Warden, State Prison*, 216 A.2d 432 (Conn. 1966) 16

Meinhard v. *Salmon*, 249 N.Y. 458, 164 N.E. 545 (1928) 40

Missouri v. *Ross*, 299 U.S. 72 (1936) 16

Newmark v. *RKO General, Inc.*, 425 F.2d 348 (2d Cir. 1970), *cert. denied*, 400 U.S. 854 (1970) 28

In re The Crowell-Collier Publishing Co., Securities Act Release No. 3825, Exchange Act Release No. 5562 (1957), [1957-1961 Transfer Binder] CCH Fed. Sec. L. Rep. ¶76,539 39

Pen-Ken Gas & Oil Corp. v. *Warfield Natural Gas Co.*, 137 F.2d 871 (6th Cir. 1943) 16

SEC v. *Micro-Moisture Controls, Inc.*, 148 F.Supp. 558 (S.D.N.Y. 1957), *aff'd sub nom. SEC* v. *Culpepper*, 270 F.2d 241 (2d Cir. 1959) 39

PAGE

SEC v. *Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied sub nom. Kline* v. *SEC*, 394 U.S. 976 (1969) 20

Simon v. *Sunasco, Inc.* [1969-1970 Transfer Binder] CCH Fed. Sec. L. Rep. ¶92,547 (S.D.N.Y. 1970) 17

Smolowe v. *Delendo Corp.*, 136 F.2d 231 (2d Cir. 1943), *cert. denied*, 320 U.S. 751 (1943) 27

Stella v. *Graham-Paige Motors Corp.*, 104 F. Supp. 957 (S.D.N.Y. 1952) 13, 27, 36

Stella v. *Graham-Paige Motors Corp.*, 132 F.Supp. 100 (S.D.N.Y. 1955), *modified in other respects*, 232 F.2d 299 (2d Cir. 1956), *cert. denied*, 352 U.S. 831 (1956) 23, 29

Sturges v. *Crowninshield*, 17 U.S. (4 Wheat.) 122 (1819) 12

United States v. *Elgin, Joliet & Eastern Ry.*, 298 U.S. 492 (1936) 16

United States v. *General Geophysical Co.*, 296 F.2d 86 (5th Cir. 1961), *cert. denied*, 369 U.S. 849 (1962) 38

United States v. *Martin*, 337 F.2d 171 (8th Cir. 1964) .. 11

United States v. *Oregon*, 366 U.S. 643 (1961) 25

United States v. *Sullivan*, 332 U.S. 689 (1948) 11, 12

Vroon v. *Templin*, 278 F.2d 345 (4th Cir. 1960) 11, 26

62 Cases of Jam v. *United States*, 340 U.S. 593 (1951) 35

Statutes

15 U.S.C. § 78c(a)(13) 27

15 U.S.C. §78c(a)(14) 27

15 U.S.C. §78p(a) 1, 16, 17, 18

15 U.S.C. §78p(b) ..... 1, *et passim*

PAGE

Rules

S.E.C. Rule 10b-5, 17 C.F.R. §240.10b-5 ..... 20, 34

S.E.C. Rule 16a-4, 17 C.F.R. §240.16a-4 26

S.E.C. Rule 16a-10, 17 C.F.R. §240.16a-10 17

Other Authorities

Brief for S.E.C. as Amicus Curiae, *Stella* v. *Graham-Paige Motors Corp.*, 104 F.Supp. 957 (S.D.N.Y. 1952) 14

H.R. 7852 and S. 2693, 73d Cong., 2d Sess. (1934) 19, 25

Hearings on S. 84, S. 56 and S. 97 Before the Senate Committee on Banking and Currency, 72d Cong., 2d Sess. and 73d Cong., 1st and 2d Sess., (1934) 27

Hobbet, *The Step Transaction Doctrine and Its Effect on Corporate Transactions,* Proceedings of the Nineteenth Annual Tulane Tax Institute, 102 (H. Fuller ed. 1970) 38

2 Loss, Securities Regulation (2d Ed. 1961) 13, 19, 20

5 Loss, Securities Regulation (Supp. 1969) 13

2 Sutherland, Statutory Construction (3d Ed. 1943) .. 16

Seligman, "Problems Under the Securities Exchange Act," 21 Va. L. Rev. 1 (1934) 13

In the
Supreme Court of the United States

OCTOBER TERM, 1971

No. 70-79

RELIANCE ELECTRIC COMPANY,

Petitioner,

vs.

EMERSON ELECTRIC COMPANY,

Respondent.

On Writ of Certiorari To The United States Court of Appeals
For The Eighth Circuit

BRIEF FOR RESPONDENT

STATUTE INVOLVED

The portions of Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), relevant here are:

> Section 16(b). For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner [the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 12 of this title]*, direc-

* The bracketed words are from Section 16(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(a).

> tor, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. . . . This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

QUESTION PRESENTED

When the beneficial owner of more than 10% of a company's stock, within six months of the purchase of that stock (a) deliberately sells enough of the stock to reduce his holdings to less than 10% in order to avoid possible "short swing" profit liability by reason of an involuntary "sale" resulting from a forthcoming merger which he had opposed and (b) thereafter, in a separate and unrelated transaction prior to the merger, sells the balance of his stock to the issuer company with the approval of the company's merger partner, is he liable under the "short swing" profit provision of § 16(b) of the Securities Exchange Act of 1934 for the second sale in view of the exemption provision of § 16(b), which expressly states that §16(b) "shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale"?

STATEMENT OF THE CASE

Some of the facts of this case have been set forth in the briefs of petitioner Reliance Electric Company (hereinafter "Reliance") and the Securities and Exchange Commission (hereinafter "SEC") and will not be restated. However, certain relevant facts omitted from those statements need to be presented.

The events leading up to this case began on May 22, 1967, when Emerson Electric Company, St. Louis, Missouri, (hereinafter "Emerson") published a tender offer for the common stock of Dodge Manufacturing Company, Mishawaka, Indiana, (hereinafter "Dodge") (A. 19-23). Dodge was a publicly owned corporation whose shares were listed on the New York Stock Exchange. Immediately upon publication of the tender offer, the Dodge board voted to oppose it. Communications were immediately transmitted to all Dodge shareholders urging them to reject the tender offer (A. 74-77). On May 25, in further pursuit of its vigorous efforts to foreclose Emerson, Dodge announced it had entered into an agreement in principle to merge into Reliance. It communicated with its shareholders urging them to approve the merger and reject Emerson's tender (A. 78-79).

Furthermore, on May 27, Dodge filed suit in the United States District Court for the Northern District of Indiana, seeking an injunction prohibiting Emerson from further pursuing its tender offer or accepting any tenders. Dodge charged Emerson, *inter alia*, with misuse of allegedly confidential insider information acquired from Dodge (A. 81-90). Following an extended hearing, the District Court on June 8 denied Dodge's request for a preliminary injunction (A. 61, 91). The court specifically found that Emerson had acquired no confidential or other insider in-

formation from or about Dodge and that all its knowledge concerning Dodge had been gleaned from publicly available sources (A. 97).

Dodge's opposition was successful in that only 152,282 shares (13.2% of Dodge's outstanding shares) were tendered. Emerson's tender offer was consummated on June 16, 1967, at which time Emerson purchased all tendered shares. Emerson paid $63.00 per share—$18.25 more per share than the price at which Dodge stock was traded on the New York Stock Exchange on the last trading day before Emerson announced its tender offer (A. 15, 19, 70).

In opposition to the Reliance merger offer, Emerson determined to make a counter proposal to Dodge shareholders that Dodge be merged into Emerson (A. 102-05). The Dodge board vigorously opposed the Emerson counter merger proposal, refused to submit it to the shareholders, and refused Emerson's statutory demand that it furnish, or allow Emerson to examine, the list of Dodge shareholders (A. 110-12). Emerson obtained that list only upon judgment of the Circuit Court of St. Joseph County, Indiana in an action commenced in that court by Emerson (A. 113-22). The Dodge board called a special meeting of Dodge shareholders for August 22 to vote upon the Reliance merger (A. 130-31). The Board, by written communications, urged the shareholders to approve the merger (A. 130-31, 146-48). Emerson sought to have its merger offer submitted to the Dodge shareholders (A. 108-09, 122-24). Dodge management refused Emerson's request (A. 124-25). Emerson then resorted to a vigorous proxy contest in opposition to the Reliance merger (A. 125-26, 132-46, 149-54). Emerson brought suit in the United States District Court for the Northern District of Indiana to compel Dodge to afford Emerson access to Dodge shareholders, and to enjoin Dodge from making

false and misleading statements to its shareholders and others about Emerson's merger proposal (A. 127-29).

Emerson's attempt to compel submission of its merger proposal to the Dodge shareholders was unsuccessful. At the Dodge shareholder's meeting on August 22, the Reliance merger was approved, to become effective on or about September 30, 1967 [less than six months after Emerson's June 16th purchase of Dodge stock] (A. 65).

Between the period of the tender offer and the launching of the proxy contest, Emerson and its counsel became concerned about §16(b) of the Securities Exchange Act of 1934 (hereinafter referred to as the "Exchange Act"). Since, by virtue of its tender offer, Emerson had become the holder of more than 10% of the Dodge common stock on June 16th (A. 15, 17), and since there was a substantial danger that Emerson would be considered to have "sold" these shares (within the meaning of §16(b)) should the Dodge-Reliance merger be consummated despite its opposition, Emerson was faced with possible involuntary §16(b) short swing profit liability (A. 36).

On June 26, 1967, Emerson received the formal opinion of its counsel discussing both tax and §16(b) considerations presented by Emerson's Dodge tender offer shareholdings in the light of the anticipated Dodge-Reliance merger (A. 15-16, 33-38). With respect to §16(b), counsel concluded that (A. 38):

> "... it is important for Emerson to reduce its holdings of Dodge stock to less than 10% prior to the Dodge stockholders' meeting."

After the Dodge-Reliance merger was approved, but before it was consummated, the president of Emerson discussed with a representative of Goldman, Sachs & Co. a proposal by Emerson that Goldman, Sachs & Co. purchase

37,000 shares of the Dodge stock then held by Emerson. Prior to this conversation, Emerson had neither made an offer to sell nor received an offer to buy Dodge shares (A. 16). On August 28, 1967, Goldman, Sachs & Co. agreed to buy the 37,000 shares at $68 per share, less commissions, transfer taxes and stock exchange fees (A. 16, 41-42). The sale was consummated on the New York Stock Exchange that day (A. 155). Following the sale, Emerson still owned 115,282 shares, or 9.96% of the 1,157,437 total Dodge shares outstanding (A. 17).

The following day, Reliance's counsel telephoned Emerson's attorneys and suggested that Emerson sell its remaining Dodge stock to Dodge. Prior to this time, Emerson had not offered to sell any of these shares to anyone (A. 16-17). Negotiations with Reliance and Dodge officials ensued and, on September 11, 1967, a written agreement of purchase by Dodge of Emerson's 115,282 shares at $69 per share* was entered into (A. 43-45). The sale was closed on September 13, 1967 (A. 17).

In connection with and prior to this sale, both Dodge and Reliance, by their counsel, wrote Emerson advising Emerson that they had considered the §16(b) problems attendant upon the 37,000 share purchase by Goldman, Sachs & Co. and the proposed purchase by Dodge, and had no intention of asserting any §16(b) claim against Emerson "for any so-called 'short-swing' profits" which

---

* As an integral part of the purchase contract, Emerson agreed (a) that it would take no action to obstruct the proposed merger of Dodge into Reliance; (b) that it would dismiss with prejudice certain pending litigation against Dodge; (c) that it would waive its rights as a dissenting stockholder of Dodge; and (d) that any tax ruling received by Emerson would not be used by it as the basis for any claims or court proceedings against Dodge or Reliance or any of their employees, officers or directors (A. 44, 46).

Emerson might realize with respect to the purchase by Dodge of the remainder of Emerson's stock (A. 48).

On September 29, 1967, Dodge merged into Reliance, and Dodge stockholders received shares of Reliance in exchange for their Dodge stock (A. 18).

In proxy materials, dated November 15, 1967, issued by Reliance in respect of a proposed merger of Toledo Scale Corporation into Reliance, Reliance discussed the then-completed purchase by Dodge of the 115,282 shares owned by Emerson (A. 155-56). Reliance reaffirmed its position that §16(b) was inapplicable, stating that:

> "'On September 13, 1967 Emerson sold 115,282 Dodge shares to Dodge at a price of $69 per share. *Reliance does not believe that Section 16(b) is applicable to such sale since Emerson was not then the holder of 10% or more of the outstanding shares of Dodge.* Counsel for Emerson furnished its opinion to that effect and counsel for both Reliance and Dodge concurred in that opinion." (A. 156.) (Emphasis added.)*

By letter dated December 28, 1967, the Reliance board of directors received a shareholder demand that they proceed against Emerson in an attempt to recover any profits Emerson might have made in Dodge stock (A. 7-8). Reliance responded, on February 13, 1968 (A. 8-9), by demanding from Emerson any short-swing profits made by it *on the first sale to Goldman, Sachs & Co.* However, Reliance, by its counsel, specifically declined, however, to make any demand with respect to Emerson's second sale of Dodge stock—the only sale in issue here. The letter read:

> "We have previously stated that, in our opinion, the profits which Emerson may have made on such sale are

* The "occurrence" opinion referred to is the September 11, 1967 letter of counsel for Dodge and Reliance. (A. 48).

not recoverable by Reliance, *since Emerson was not then the owner of 10% or more of the outstanding stock of Dodge.* Nothing has developed to change that opinion. Accordingly, our demand does not relate to the profits realized by Emerson on such sale." (A. 9.) (Emphasis added.)

Faced with this demand, Emerson on February 29, 1968 brought this action seeking a declaratory judgment as to its liability, if any, for profits on either of the sales of Dodge stock (A. 3-6). Reliance filed a counterclaim asserting, for the first time, and directly contrary to its prior position, that Emerson was liable for profits made on both sales. (A. 10-13).

SUMMARY OF ARGUMENT

The issue presented by this case is whether the sale by Emerson (a former owner, but *not* at the time of the sale, of more than 10% of Dodge stock) of 115,282 shares of Dodge stock is exempted from the "short swing" profit provisions of §16(b).

When Emerson sold its Dodge stock in two *bona fide,* independent, open, separate and deliberate sales to two different purchasers at two different times, it was merely following, pursuant to the advice of its counsel, the plain language of the exemption provision of §16(b) as Congress wrote and enacted it and presumably intended it to be applied. The first sale was intended to bring Emerson's remaining share ownership below the 10% ownership level, so as to bring the anticipated involuntary "sale," through merger, of the remainder within the exemption provision of §16(b). This also had the effect of placing the subse-

quent sale for cash at the instance of Reliance within the exempting provision, which clearly provides that sales by a former 10% holder are exempted from §16(b) if, when made, the seller owns 10% or less, even though made within six months from the time the seller initially became a 10% owner.

The statutory exemption which excludes Emerson's second sale is couched in clear, unambiguous language and is to be applied as written. "Construction" of the exemption, absent any threshold ambiguity, is inappropriate. Neither recited generalized purposes of the law nor legislative history may be invoked to contradict, restrict, expand or otherwise alter the plain language of the statutory exemptive provision.

The "interpretations" urged by Reliance and the SEC are in actuality requests that this Court rewrite the plain words of this statute to read differently from the words Congress itself wrote and enacted as law. Reliance and the SEC present no authority supporting their proffered positions. In fact, all prior authority respecting §16(b)'s exemption provision has been affirmatively and expressly to the effect that a second sale, at a time when the 10% owner no longer has over 10% of the class of stock, is exempt from §16(b). Emerson relied on this prior authority, as it had a right to do.

Even were the Court to consider this case in light of the general remedial purpose of §16(b) to curb abuses of inside information, Emerson's second sale would still be exempt. Emerson, opposed in every way by Dodge and its management, was in no position to acquire, and in fact did not acquire, inside information from Dodge or from any other source. Absent this, there was no potential for

abuse and imposition of liability upon Emerson would not serve the purposes of §16(b).

Assessment of liability would impose an artificial "insider" label on Emerson, at a time when it lacked that statutory status, would inflict on it an unconscionable liability and, ironically, confer upon Reliance a substantial windfall in the face of the fact that it suggested, negotiated, approved, facilitated and participated in the second sale.

ARGUMENT

I. SECTION 16(b) ON ITS FACE PROHIBITS ITS APPLICATION TO EMERSON'S SECOND SALE.

Explicit and unambiguous statutory provisions are to be applied as written. *United States* v. *Sullivan*, 332 U.S. 689, 693 (1948); *United States* v. *Martin*, 337 F.2d 171, 174 (8th Cir. 1964); *Vroon* v. *Templin*, 278 F.2d 345, 348 (4th Cir. 1960).

A. The Parties, The SEC And Both Courts Below Are Unanimous That Emerson Was Not A 10% Owner At The Time Of The Second Sale. The Last Sentence Of §16(b) Clearly Exempts That Sale From Liability.

Congress deliberately included in §16(b) an exemption provision limiting its application to persons who are "insiders" solely because they are owners of more than 10% of an issuer's securities.[1] This limitation is unambiguous. It reads:

> "This subsection shall not be construed to cover *any* transaction where such beneficial owner was not such *both* at the time of the purchase and sale, or the sale and purchase, of the security involved. . . ." (Emphasis added.)

By this straightforward provision, Congress exempted Emerson's second sale, which concededly[2] occurred when

---

[1] Although the "beneficial owner" of §16(b) refers to an owner of *more* than 10% of the corporate securities involved, for purposes of brevity such an owner is hereinafter referred to as a "10% owner" or a "10% holder."

[2] See Brief of Petitioner Reliance (hereinafter "Reliance Brief"), page 4; Brief of Securities and Exchange Commission (hereinafter "SEC Brief"), page 4; Opinion of United States District Court for the Eastern District of Missouri, A. 162; and Opinion of the United States Court of Appeals for the Eighth Circuit, A. 179-80.

Emerson was no longer a 10% holder. *See Adler* v. *Klawans;* 267 F.2d 840, 845 (2d Cir. 1959). The Court of Appeals properly applied the Congressional exemption mandate.

The plain meaning of a statute may not be disregarded by the courts. *Sturges* v. *Crowninshield,* 17 U.S. (4 Wheat.) 122, 202-203 (1819); *United States* v. *Sullivan,* 332 U.S. 689, 692-93 (1948). As this Court has heretofore held, §16(b) must be applied as actually written by Congress, not as some litigant would have it written. *Blau* v. *Lehman Brothers,* 368 U.S. 403, 410 (1962).

The clear meaning of the exemption was understood by all parties to this case. On the basis of the express wording of the exemption provision of §16(b), Emerson's counsel advised his client that, while liability might attach to its first sale of Dodge stock made when it held more than 10% of that stock, any sale at a time Emerson owned less than 10% of the outstanding Dodge shares would be exempt (A. 35-38). At the closing of the sale of the 115,282 shares to Dodge, Reliance and Dodge and their counsel, then fully apprised of the facts of the first sale, all agreed that the second sale was exempt from §16(b) (A. 48-49). In addition, subsequent to the consummation of the merger of Reliance and Dodge, Reliance voluntarily and publicly affirmed this position in proxy material it issued in respect of an unrelated merger transaction (A. 156). Still later, confronted with a shareholder demand upon Reliance that it seek recovery against Emerson with respect to profits realized by Emerson on the second sale, counsel for Reliance again reiterated their opinion that the second sale was exempt from §16(b). Reliance accordingly limited its demand to profits on the first sale (A. 9).

In addition all prior analysis by scholars of §16(b) and its exemption provision had consistently concluded that the second sale was exempt if at that time the seller was no longer a 10% holder. As early as 1934, shortly after the Exchange Act was enacted, one commentator observed that:

> ". . . the intention of the language was to exclude the second sale in a case where 10% is purchased, 5% sold within three months, and the remaining 5% a month later. *This latter construction of the Act is, it is believed, the only safe one to rely upon.*" Seligman, "Problems Under the Securities Exchange Act," 21 Va. L. Rev. 1, 20 (1934). (Emphasis added.)

Professor Louis Loss reached the same conclusion:

> ". . . a person who owns 15 percent and wants to sell down to 5 percent should sell 5-plus percent in one transaction and then, after he becomes a holder of slightly less than 10 percent, sell out the remainder." 2 Loss, *Securities Regulation* 1060 (2d Ed. 1961).[3]

Furthermore, four federal courts, as well as the SEC, indicated that a sale of shares by a one time 10% owner falls within the liability provisions of §16(b) only if he is a 10% holder *at the time of the sale.* As the court said in *Stella* v. *Graham-Paige Motors Corp.,* 104 F.Supp. 957, 960 (S.D.N.Y. 1952), citing *Seligman, supra*:

> "Assuming that a shareholder becomes subject to the liability imposed by the statute immediately upon be-

---

[3] In a later supplement, Professor Loss corrected his earlier text to note that the shareholder need only sell down *to* 10% (rather than *under* 10%) and thereafter may dispose of the remainder of his shares free of §16(b). 5 Loss, *Securities Regulation* 3023 (Supp. 1969).

> coming the owner of more than 10% of the equity shares of a corporation, it would appear that the exemption provision was intended 'to exclude the second sale in a case where 10% is purchased, 5% sold within three months and the remaining 5% a month later.' "

The SEC urged that interpretation upon the court in the *Stella* case in its *amicus* brief saying in that regard:

> "The exemption applies only to transactions of purchase and sale when the stockholder has less than ten per cent of any class of equity securities of the issuer. Thus any purchases or sales made by defendant prior to February 10, 1947 [the date of the purchase by which Graham-Paige became a 10% stockholder] would not be included in any computation of profit. *Obversely, the exemption would exclude any sales made after defendant ceased to be a ten per cent holder.*" (Emphasis added.) Brief for SEC as Amicus Curiae at 7-8.

Accord, Feder v. *Martin Marietta Corp.*, 406 F.2d 260, 266-67 (2d Cir. 1969), *cert denied*, 396 U.S. 1036 (1970);[4] *Ad-*

---

[4] "It must be emphasized, of course, that the statute evidences a clear legislative intent to treat corporate directors and officers in one category of insiders and 10% shareholders in another. The act expressly sets forth that the liability of a 10% shareholder to surrender his short-swing profits is conditional upon his being such both at the time of purchase and at the time of sale, but there is no such limitation in the case of officers and directors. [Adler v. Klawans,] 267 F.2d at 845; Blau v. Allen, 163 F.Supp. 702, 704 (SDNY 1958). See also 2 Loss, Securities Regulation 1060 (2d ed. 1961)." 406 F.2d at 266-67. (Footnote omitted.)

ler v. *Klawans*, 267 F.2d 840, 845 (2d Cir. 1959);[5] *Blau* v. *Allen*, 163 F.Supp. 702, 704 (S.D.N.Y. 1958).[6]

Since the foregoing interpretation of §16(b) was made by the courts, the interested legal community and the public,

---

[5] "The statute itself, independent of its legislative history, seems to treat directors and officers as one category of 'insiders' and 10% beneficial owners as another. There is, of course, a logical and practical basis for distinction. Generally, although there are important exceptions in certain circumstances, officers and directors have more ready access to the intimate business secrets of corporations and factors which can affect the real and ultimately the market value of stock than does even so large a stockholder as a '10% beneficial owner.' This is not to discount the potential influence of the latter but simply to acknowledge the basis for the different treatment accorded them by Congress. Moreover, a director or officer can usually stimulate more directly actions which affect stock values and have knowledge of factors which might depress values. Notwithstanding exceptions and variations these general propositions have a foundation in experience and furnish an adequate basis for a difference in treatment of 10% owners. Beyond doubt it was considerations of this character which led Congress to make a provision concerning 10% owners which was not made with respect to officers and directors. It is found in the language:

> 'This subsection shall not be construed to cover any transaction where *such beneficial owner* was not such *both* at the time of purchase and sale, or the sale and purchase, of the security involved * * *' (Emphasis added.)

"Under the familiar canon of construction, *expressio unius est exclusio alterius*, the presence of this emphatic and unmistakable clause in the portion governing the one class demonstrates a clear legislative intent that no such provision applies to the other. [Citations omitted.]" 267 F.2d at 845.

[6] "In addition, it is significant that while the proscriptions of section 16(b) apply to a 10% beneficial owner only if he is such both at the time of purchase and sale, there is no such limitation in the case of officers and directors." 163 F.Supp. at 704.

commencing at a time shortly after the enactment of the statute and has been persisted in over many years, and since Congress has not seen fit to amend §16(b) in any respect, although it amended other sections (including §16(a)) of the Exchange Act, application of the rule of contemporaneous construction and interpretation is warranted. The long continued contemporaneous construction of §16(b) by the bar is entitled to great weight. *Pen-Ken Gas & Oil Corp.* v. *Warfield Natural Gas Co.*, 137 F.2d 871, 880 (6th Cir. 1943); *McBrien* v. *Warden, State Prison*, 216 A.2d 432, 438 (Conn. 1966); *see* 2 Sutherland, *Statutory Construction*, §§5103-04, 5106-07, 5109 (3d Ed. 1943).

This Court has often held that failure of the Congress or a state legislature to amend a statute in the face of continuing contemporaneous construction is presumptive evidence of the correctness of that construction. *Electric Storage Battery Co.* v. *Shimadzu*, 307 U.S. 5, 14 (1939); *Missouri* v. *Ross*, 299 U.S. 72, 75 (1936); *United States* v. *Elgin, Joliet & Eastern Ry.*, 298 U.S. 492, 500 (1936).

Until the decision of the district court in this case, which the Court of Appeals reversed, the rule stated above has been unanimously accepted by all of the authorities who have dealt with the question. Neither Reliance nor the SEC has presented any authority whatsoever which is arguably to the contrary, and we have found none. Indeed, it was not until Reliance in this case executed an about face and claimed that Emerson was liable to it for the short swing profits that resulted from Emerson's second sale that any agency, law commentator or court had even *suggested* any doubt respecting the clear command of the exemption provision of §16(b).

B. Other Language In §16, And The Rules And Regulations Promulgated By The SEC, Buttress The Conclusion Of The Court Of Appeals.

Section 16(b) applies to "such" beneficial owner; the owner referred to is the one defined in the monthly reporting requirements of changes of ownership contained in §16(a), *i.e.*, "the beneficial owner of more than 10 per centum of any class of any equity security . . . which is registered on a national securities exchange." 15 U.S.C. §78p(a). Section 16(a) does not require a monthly report of changes in ownership by one holding less than a 10% stock position during that month.

Inasmuch as Emerson's second sale of Dodge stock occurred in September, 1967, on no day of which was Emerson a 10% owner, Emerson had no obligation under §16(a) to report that sale. Not being subject to §16(a), Emerson was *ipso facto* not a "beneficial owner" within §16(b). *Cf. Simon* v. *Sunasco, Inc.*, [1969-1970 Transfer Binder] CCH Fed. Sec. L. Rep. ¶92,547 at page 98,510 (S.D. N.Y. 1970).

This conclusion is confirmed by the SEC's own rules in this area. Section 16(b) contains an exemption for "any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection." Pursuant to this authority, the SEC by Rule 16a-10[7] exempted from §16(b) those transactions exempt from §16(a). The SEC only requires reports under §16(a) of stockholders (other than officers and directors) who are 10% owners in the particular

---

[7] "Any transaction which has been or shall be exempted by the Commission from the requirements of section 16(a) shall, in so far as it is otherwise subject to the provisions of section 16(b), be likewise exempted from section 16(b)." 17 C.F.R. §240.16a-10.

month. Form 4, SEC Release No. 6487 of March 9, 1961.[8]

Since Emerson was not a 10% owner in September, 1967, it did not have to report under §16(a) and was exempt from §16(b).

II. CONGRESS INTENTIONALLY LIMITED THE REACH OF §16(b).

Congress enacted §16(b) of the Exchange Act:

> "[f]or the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner [i.e., the owner of more than 10% of the issuer's securities] . . . by reason of his relationship to the issuer . . . ." 15 U.S.C. 78p(b).

In implementing this purpose, Congress deliberately chose not to cover the full range of possible abuses of inside information[9] by §16(b). Liability is imposed only upon

---

[8] Instructions to Form 4 state in part:

> "1. Persons Required to File Statements.
> Statements on this form are required to be filed by each of the following persons:
> (a) Every person who at any time during any calendar month was (i) directly or indirectly the beneficial owner of more than 10 percent of any class of equity securities (other than exempted securities) listed and registered on a national securities exchange . . . and who during such month had any change in his beneficial ownership of any class of equity securities of such company. . . ."

[9] "Large areas of 'insider' conduct were consciously left untouched by Congress for reasons dictated by practicalities rather than ethics or pure logic. A line had to be drawn somewhere by the lawmakers. . . ." *Adler* v. *Klawans*, 267 F.2d 840, 845 (2d Cir. 1959). *Accord, Blau* v. *Max Factor & Co.*, 342 F.2d 304, 307 (9th Cir. 1965), *cert. denied*, 382 U.S. 892 (1965).

certain persons (officers, directors and 10% owners), and only in specific circumstances (when purchases and sales, or sales and purchases, occur within a period of less than six months, and in the case of a 10% owner only if he owns more than 10% of the stock at the time both of purchase and of sale).

There are many instances of actual use of inside information that §16(b) does not cover. *See, e.g.*, 2 Loss, *Securities Regulation* 1042-43 (2d Ed. 1961). Sales on dates six months or more after acquisition of the 10% ownership are exempt—the difference need be only one day.[10] An insider may trade for years on the basis of inside information without being covered by §16(b) if he avoids matching transactions within less than 6 months. Trading by persons owning substantial amounts of stock, but 10% or less, is exempt.[11] Corporate employees who are not officers or directors are not covered by §16(b) even though they have inside information. *See, Lockheed Aircraft Corp.* v. *Campbell*, 110 F.Supp. 282, 286 (S.D. Calif. 1953). The section does not apply to trades by noninsider tippees[12], and mutual trading by corporate insiders on re-

---

[10] ". . . for the insider who waits six months and one day after purchase to avoid a short term gain there is no 'bite' at all except as conscience calls the use of inside information on sales after six months as reprehensible as on sales within six months. One can speculate on whether the moral or ethical values are altered by the passage of 24 hours but the statute makes an honest if not honorable man out of the insider in that period." *Adler* v. *Klawans*, 267 F.2d 840, 845 (2d Cir. 1959).

[11] Earlier drafts of the section fixed 5% rather than 10% stock ownership as the "insider" definition. *See* §15(b), H.R. 7852 and S. 2693, 73d Cong., 2d Sess. (1934).

[12] Early drafts of the Act would have prohibited tipping. See §15(b), H.R. 7852 and S. 2693, 73d Cong., 2d Sess. (1934).

ciprocal tips is exempt. 2 Loss, *Securities Regulation* 1043 (2d Ed. 1961); *Blau* v. *Lehman*, 368 U.S. 403, 411-12 (1962).

This intentionally limited scope is proper in light of the automatic liability imposed by §16(b), *Bershad* v. *McDonough*, 428 F.2d 693, 696 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971), under which the innocent are liable as well as the guilty. *See Ferraiolo* v. *Newman*, 259 F.2d 342, 344 (6th Cir. 1958), *cert. denied*, 359 U.S. 927 (1959).

Section 16(b)'s limited scope is additionally appropriate when viewed against the complementary remedies of a more general nature afforded by other provisions of the Exchange Act. For example, the Exchange Act also contains Section 10(b), implemented by SEC Rule 10b-5, which prohibits all acts and courses of conduct connected with securities transactions that are fraudulent or manipulative. All of the instances noted above as abuses of inside information not covered by §16(b) are prohibited by Rule 10b-5. *See SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 852 (2d Cir. 1968), *cert. denied sub nom. Kline* v. *SEC*, 394 U.S. 976 (1969), (trading by insiders and tippees on inside information).[13]

---

[13] Reliance suggests (Reliance Brief, page 10 n. 5) that §10(b) is an inadequate alternative to Reliance's urged reading of §16(b), on the grounds that §10(b) is not applied automatically but requires a factual inquiry into actual abuse. Yet Reliance is the one who here contends that §16(b) should *not* be "automatically" applied as written to exempt Emerson's second sale, and who urges this Court to adopt a new element of §16(b) [*i.e.*, intent of defendant as to "predetermined plan of disposition"] which would necessitate factual inquiry on a case-by-case basis.

Reliance and the SEC insist that even though Emerson's second sale is not within the words of §16(b),[14] that provision should be expanded, in fact rewritten, to impose liability, and this in the face of the fact that §16(b) is drafted so as to make it applicable to a limited number of factual situations.

III. NONE OF THE "PRINCIPLES OF CONSTRUCTION" URGED BY RELIANCE AND THE SEC SUPPORT THEIR REQUESTED REWRITING OF THE EXEMPTION PROVISION OF §16(b).

Everyone concedes that Emerson owned only 9.96% of Dodge's stock when it made its second sale. However, both Reliance and the SEC, upon different theories, request this Court to "construe" §16(b) to cover that sale by *rewriting* the exemption provision to their individual specifications. The statute expressly says that this *shall not* be done.[15]

A. Both Reliance And The SEC Would Have This Court Emasculate The Exemption Provision Of §16(b).

Reliance's position is that the exemption provision of §16(b) protects 10% holders who inadvertently or accidentally sell or otherwise dispose of their stock sufficient to reduce their holdings to less than 10% and then sell the remainder, but not to 10% holders who knowingly and deliberately do so in order to avoid the penalty provisions

---

[14] Reliance realizes that §16(b) as written does not cover Emerson's second sale when it suggests that, in this respect, there is a "deficiency" in the statute. Reliance Brief, page 10, n. 5.

[15] " . . . this subsection *shall not be construed* to cover any transactions where [the 10% holder] . . . was not such . . . at the time of the . . . sale . . . ." 15 U.S.C. 78p(b). (Emphasis added.)

of §16(b). Reliance reaches this startling result by reading the word "sale" to cover multiple sales when the 10% holder has a predetermined plan to dispose of his stock in several sales within six months. (Reliance Brief, "Question Presented", page 3).

In the first place, Reliance's argument is factually wrong. There is no dispute that the first sale was made because Emerson feared that the forthcoming Reliance-Dodge merger, which it had opposed, would result in an *involuntary* "sale" of Emerson's stock within the meaning of §16(b). Emerson sold enough to reduce its holdings below 10% in order to avoid such a result. The second sale, *i.e.* the sale to Dodge, was *concededly not anticipated* at the time of the first sale, and was initiated by Reliance, not Emerson.

This reading is contrary to the statute,[16] prior §16(b) cases,[17] the record and the opinions of the two courts below. Reliance's suggestion that Emerson's two sales should be treated as one "sale" for §16(b) purposes has already been twice rejected. Although the district court did construe "time of sale" (A. 164), it found as a fact that "the two sales of Dodge stock were technically separate transactions and the second sale was not 'legally' tied in any way to the first sale" (A. 163); this latter finding was expressly adopted by the Eighth Circuit (A. 180).

All of the cases cited by Reliance in support of its proposition deal with the issue of whether one event, not considered a purchase or sale in normal parlance(*e.g.*, an option, exchange of shares pursuant to merger, or conversion of convertible preferred stock), is nevertheless a purchase or sale as broadly defined by the statute. None

---

[16] *See* pp. 13-16 *supra.*

[17] *See* pp. 26-32 *infra.*

support the proposition, urged here by Reliance although neither court below agreed, that the *two totally independent sales* constituted "a sale" for purposes of §16(b).[18]

The SEC, on the other hand, does not share Reliance's concept of treating the two sales as a single "sale". The SEC's theory is that the words "at the time of the purchase *and* sale" should be ignored if at any time within the six month period preceding a sale the seller was a 10% shareholder. The SEC disregards the fact that the exemption provision of §16(b) deals with the status of the 10% holder at the time of *each* purchase or sale.[19]

---

[18] *Abrams* v. *Occidental Petroleum Corporation*, 323 F.Supp. 570 (S.D.N.Y. 1971), *appeal docketed*, Nos. 71-1273-4-5-6, 2d Cir., and *Stella* v. *Graham-Paige Motors Corp.*, 132 F.Supp. 100 (S.D.N.Y. 1955), *modified in other respects*, 232 F.2d 299 (2d Cir. 1956), *cert. denied*, 352 U.S. (1956), cited by Reliance at pages 21-22 of its brief, are not authority to the contrary. In *Abrams*, the district court concluded that defendant's tender offer constituted "one act". It did *not* hold, as Reliance erroneously implies, that all the individual purchases pursuant to the offer together constituted "one purchase."

In *Stella*, the district court was concerned with whether three sales of stock, to two different purchasers, were sold within the less-than-six-month period. Defendant in that case owned, at the time of and following each of the three sales, more than 10%. Contrary to Reliance's citation of this case for the proposition that two independent sales may be treated as one sale (Reliance Brief, page 22), the court in *Stella* found that the sales occurred on *two* dates and spoke of *multiple* sales and contracts to sell.

[19] The SEC argues: "A person is liable under Section 16(b) of the Securities Exchange Act of 1934 for profits realized by him from a purchase followed within six month by *sales* of a corporation's stock, where such person becomes a more than 10 percent beneficial owner of the corporation's stock by virtue of the purchase and is a more than 10 percent beneficial owner *at any time* during the period in which the *sale transactions* occur." SEC Brief, page 14. (Emphasis added.)

Under the SEC's reading, if a purchaser holds 10% at the time of his purchase, §16(b) applies to *all* sales made by him during the ensuing six months period irrespective of the amount of his holdings at the times of those sales. Thus, the SEC would hold a shareholder liable for all sales made by him when he buys 12% on January 1 and sells 3% on February 1, 3% on March 1, 3% on April 1, 2% on May 1, and 1% on June 25.[20]

If the position of either Reliance or the SEC is adopted, the words of the exemption provision of §16(b) that the section does not apply to a seller who holds less than 10% "*both* at the time of the purchase and sale" are rendered meaningless. This would be contrary to the settled doctrine of construction that courts will not nullify an unambiguous statutory provision under the guise of construction. *City Nat. Bank.* v. *United States,* 207 F.2d 741, 744 (10th Cir. 1953).

Reliance does not even pretend that its proffered position is supported by legislative history. However, the SEC seizes upon an isolated exchange (a question and answer suggesting that the section was not intended to apply to executors and administrators selling stock owned by an estate, see SEC Brief, pages 32-33) during the Senate hearings concerning §16(b) and, by a strained reading, asks this Court to "presume" that the exemption, which was subsequently put into the section, was designed to exclude shareholders who "involuntarily" achieve 10% status.[21]

---

[20] Indeed, the SEC would appear to contend that an owner is liable on all sales where he buys 5% on January 1 and 6% on February 1, and sells 3% on April 1, and 8% on June 1.

[21] Thus the SEC would apparently credit the exemption with meaning only where the 10% holder became such as an executor, administrator, trustee, devisee or donee, or where the percentage of his holdings has been mechanically increased by purchases or redemptions by the issuer. SEC Brief, page 30.

At best, the SEC's legislative history is irrelevant. When the provision of a statute is unambiguous, as is the one here, courts restrict themselves to the statute as written, and do not resort to legislative history to ascertain legislative intent; this for the obvious reason that the statutory provision needs no construction. There is no need to do anything but apply the statute as written by Congress. *United States* v. *Oregon,* 366 U.S. 643, 648 (1961).

Even when legislative history is consulted, it must be clear authority for the interpretation urged; the sheer speculation indulged in here by the SEC[22] to provide support for its version of the statute is insufficient. As this Court stated in *Gemsco, Inc.* v. *Walling,* 324 U.S. 244 at 260 (1945):

> "The argument from the legislative history undertakes, in effect, to contradict the terms of [the statute] by negative inferences drawn from inconclusive events occurring in the course of consideration of the various . . . bills which finally . . . emerged . . . as the Act. The plain words and meaning of a statute cannot be overcome by a legislative history which, through strained processes of deduction from events of wholly ambiguous significance, may furnish dubious bases for inference in every direction. This is such a case."

Finally, the most conclusive evidence that Congress did not intend §16(b) to mean what the SEC says (*i.e.* that only involuntary 10% holders are exempt)[23] is the incontroverti-

---

[22] *See, e.g.,* SEC Brief, page 32.

[23] To the extent that Congress was in fact concerned about inadvertently imposing liability on the particular classes of holders mentioned by the SEC, it should be noted that the coverage of the statute finally passed—"beneficial owner"—was a revision of the first public draft of the Act which spoke of "owner of securities, owning *as of record and/or beneficially.*" H.R. 7852, 73d Cong., 2d Sess. §15(b) (1934). (Emphasis added.)

ble fact that Congress did not write the exemption provision in terms of "involuntary" 10% holders.[24] As the court said in *Vroon* v. *Templin*, 278 F.2d 345 at 348-49 (4th Cir. 1960):

> "The language of the statute is plain and is to be taken as written. We do not think it permissible to construe a statute on the basis of a mere surmise as to what the Legislature intended and to assume that it was only by inadvertence that it failed to state something other than what it plainly stated. *This is particularly true* when there is no confusion or lack of clarity in the wording of the statute and *where it could so easily have been worded to provide the meaning* [being advanced] . . . *had the law-making body so desired.*" (Emphasis added.)

B. Incantation Of "Remedial Purpose Of The Act" Does Not Justify Rewriting The Statute.

1. Application Of The Unambiguous Exemption Provision To The Ordinary Cash Sale Here Does Not Require "Construction".

Reliance and the SEC, focusing only on the "remedial purposes" of the statute rather than on the express language of the section itself, ask this Court to rewrite and

---

[24] The SEC's own Regulations cast doubt on its speculation that Congress in writing the exemption was solely concerned with "involuntary" 10% holders. Six months after §16(b) became effective, the SEC found it necessary to adopt a regulation excluding from §16(b) coverage, for 12 months after their involuntary acquisition, executors, guardians and certain other administrators of estates or assets. SEC Rule 16a-4, 17 C.F.R. §240.16a-4. If Congress was in fact attempting only to exempt "involuntary" 10% holders, the SEC apparently concluded in 1935 that Congress was not entirely successful in this attempt.

extend the reach of §16(b). They blithely ignore and seek to have this Court ignore the plain language Congress itself employed in expressly limiting the reach of the section. They ask the Court to overlook the fact that Congress intentionally *declined* to enact a statute coextensive with the recited purpose. Unambiguous statutory language may not be abandoned to pursue "remedial purposes."

Section 16(b) was initially considered to be largely "automatic"—a "crude rule-of-thumb"[25] to minimize protracted litigation. *See Smolowe* v. *Delendo Corp.*, 136 F.2d 231, 235 (2d Cir. 1943), *cert. denied*, 320 U.S. 751 (1943).

Subsequently, it became clear that "automatic application" was often impossible or inappropriate. For example, a situation arose where the language of §16(b) was arguably ambiguous and the court turned to interpretive guidelines. The question was whether the words "at the time of purchase" meant simultaneously with the purchase or immediately prior thereto. It was held in *Stella* v. *Graham-Paige Motors Corp.*, 104 F.Supp. 957, 960 (S.D.N.Y. 1953) that the phrase meant simultaneously with the purchase. In a second class of cases, unambiguous words of the statute, applied literally[26] to certain variant corporate transactions, swept into statutory coverage equitably "innocent" conduct which had not concerned Congress. With respect to this latter category of cases,

---

[25] *Hearings on S. 84, S. 56 and S. 97 Before the Senate Committee on Banking and Currency*, 72d Cong., 2d Sess. and 73d Cong., 1st and 2d Sess. at 6557 (1934).

[26] The terms 'buy' and 'purchase' each include any contract to buy, purchase, *or otherwise acquire*." 15 U.S.C. 78c(a)(13). (Emphasis added.)

"The terms 'sale' and 'sell' each include any contract to sell *or otherwise dispose of*." 15 U.S.C. 78c(a)(14). (Emphasis added.)

the court said in *Newmark* v. *RKO General, Inc.*, 425 F.2d 348, 351 (2d Cir. 1970), *cert. denied*, 400 U.S. 854 (1970):

> "The complexities of the commercial and financial world, however, have defied the draftsmen's efforts at neat classification. Whether certain 'unorthodox' transactions, well illustrated here by the exchanges of securities incident to a merger which form the basis of this appeal, are 'purchases' or 'sales' for the purposes of section 16(b) cannot be resolved by mere reference to the words of the statute. In such cases, the determination of the statute's relevance must rest, initially, on whether there exists the potential for evil against which the statute was intended to guard."

In response to these two limited classes of cases, the courts developed the "pragmatic approach" of measuring the particular facts of a case against the remedial purposes of the Act—to resolve ambiguity or to determine whether a holder, although technically *within* the statute as written, was not within its spirit, and should be *excluded* from coverage. In the case at bar, Reliance and the SEC are asking this Court to *include* in the statute's coverage a holder patently *without* the plain terms of §16(b) as written, to eliminate altogether the basic concept of applying the exemption as written where possible, and to extend unwarrantedly the device of reference to the remedial purposes of the Act.

Reliance would read "sale" as "sales"; the SEC would read "at *the* time of *the* purchase and *sale*" as "*sales* at *any* time." But here there was a simple sale of stock for cash and the statutory dictates are unambiguous. Emerson finds no case where a court faced with a straightforward cash-for-stock sale found it necessary to revert to the remedial purposes statutory construction doctrine to import an ambiguity into otherwise plain words of the stat-

ute and then by the same device resolve the self-created ambiguity, in the process changing the plain words of the statute.[27] The Court of Appeals properly applied the statute as written, which was the intention of the Congress.

Reliance (Brief, pp. 12-13) criticizes the Court of Appeals for its refusal to resort to the doctrine of remedial construction as a means of warping the otherwise plain language of §16(b) to make it applicable to Emerson's second sale. The criticism is unwarranted and misplaced. The Court of Appeals concluded, and soundly so, that the words of the exemption provision, that the seller must be the owner of more than 10% "both at the time of the purchase and sale", were plain and unambiguous so as to exclude from §16(b) a sale by a seller who, though initially an owner of more than 10%, was not a more-than-10% owner at the time of sale, irrespective of whether the interim reduction of his ownership percentage below 10% was deliberate, inadvertent or involuntary. It refused to join Reliance in reading into the statute a distinction between sellers who had intentionally reduced their ownership to less than 10% and those who had become so inadvertently.[28]

The Eighth Circuit applied the approach proper in such cases. The issues presented to the Court of Appeals were: (1) whether Emerson's profits on both sales were exempt

---

[27] Similarly, courts refuse to "construe" clear-cut statutory language by deleting words from §16(b). *See, e.g., Stella* v. *Graham-Paige Motors Corp.*, 132 F.Supp. 100, 104 (S.D.N.Y. 1955) [the words "less than" may not be deleted from the phrase "within any period of less than six months"].

[28] Reliance cites *Chemical Fund, Inc.* v. *Xerox Corp.*, 377 F.2d 107 (2d Cir. 1967), as an instance in which a court "construed the '10% beneficial owner' standard in light of the statutory purpose of Section 16(b) . . ." Reliance Brief, page 14. Reliance misapprehends the point of the *Chemical Fund* decision. The portion of §16(b) at issue in that case was not "10% beneficial owner" but rather "class of any equity security." 377 F.2d at 108.

since Emerson's Dodge holdings jumped from zero to 13.2% at the instant the tender offer was consummated, and Emerson was arguably therefor not a 10% owner "at the time of purchase", and (2) the issue presented here, of whether Emerson was a 10% owner at the time of its second sale. Since the Court of Appeals found that in its judgment a threshold statutory ambiguity was involved in the first issue, it properly resorted to legislative history and other pragmatic analysis of remedial purposes and held that the words "at the time of purchase" meant "simultaneously with."[29]

On the present issue, however, the Court of Appeals recognized that "remedial purposes" cannot serve as a substitute for words of plain meaning in a statute. Despite its expressed determination to apply §16(b) to the fullest extent possible, the Court of Appeals correctly held that resort to collateral aids to determine legislative intent was impermissible with respect to Emerson's second sale. The Court of Appeals said in that regard:

> ". . . While we agree that Section 16(b) is to be broadly and liberally construed to achieve the intent of Congress, we are unable to discern from any of the Congressional hearings or from the broad basic purpose of 16(b) any intent on the part of Congress not to mean what it has literally said in the 16(b) exclusion clause, giving the words used in that clause a liberal and reasonably flexible meaning. We are not free under the guise of statutory interpretation to

---

[29] Emerson disagreed with the Eighth Circuit's conclusions that the words "at the time of" are ambiguous and that legislative intent is served by reading those words as "simultaneously with." But that issue need not be decided by this Court in this case, since it is conceded by all parties that Emerson was not a holder of "more than 10%" at the time of the second sale. There is no threshold statutory ambiguity as to the applicability of the exemptive provision of §16(b) to the sale involved in this case.

rewrite statutes so as to include matters which for unexpressed reasons Congress did not include." (A. 182.) (Footnote omitted.)

This refusal to do by construction what Congress did not itself do by legislative drafting is sanctioned by all §16(b) precedent and is specifically mandated by this Court in *Blau* v. *Lehman Brothers*, 368 U.S. 403, 411-12 (1962).

2. The Remedial Purposes Of The Act Do Not Support The Application Of §16(b) To The Facts Of This Case.

Even if inquiry into the remedial purposes of the Act were made here, the conclusion reached by the Court of Appeals still follows, that Emerson's second sale is exempted. The purchase and two sales of Dodge stock simply were not an abuse and do not present possibilities of abuse.

Courts construing §16(b) have properly refused to apply §16(b) beyond its purpose[30] of dealing with speculative abuse of inside information. For "remedial purposes" to be relevant, therefore, it must appear both that "the transaction" empowered the defendant to engage in speculative abuses[31] and that those abuses involved the

---

[30] "For the purpose of preventing *the unfair use of information* which may have been obtained by [a 10% holder] . . . *by reason of his relationship to the issuer*. . . ." (Emphasis added.) 15 U.S.C. 78 p(b).

[31] *See, e.g., Blau* v. *Lamb*, 363 F.2d 507, 524 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967) (conversion of convertible preferred stock into common stock not a "sale" of the convertible preferred for §16(b) purposes; defendants' power as insiders to abuse inside information pre-dated the conversion, and was in no way enhanced because of it); *Blau* v. *Max Factor & Co.*, 342 F.2d 304, 308 (9th Cir. 1965) (exchange of common for Class A (common) stock not a "purchase" of the Class A stock for §16(b) purposes; defendant's ability to engage in speculative use of inside information existed *before* the exchange).

use of inside information.[32] Neither factor existed here.[33] Emerson was at all times foreclosed from *any* access whatsoever to inside information.

It is clear that Emerson fought vigorously to acquire control of Dodge. It made overtures to the management of Dodge (A. 59) which were vigorously rejected (A. 59). Emerson then launched a tender offer directed, over the heads of the resisting Dodge management, to the Dodge shareholders (A. 19-31). Dodge management vigorously resisted and succeeded in frustrating Emerson's offer. Dodge management resorted to all of the standard devices of resistance. Broadside communications were sent to Dodge shareholders urging them to reject the tender offer (A. 74-77). Dodge management brought suit to enjoin Emerson from proceeding with its tender offer (A. 81-90). Dodge management refused to give or afford Emerson access to a shareholder list until compelled to do so by court order on suit by Emerson (A. 113-22). Dodge management pre-empted Emerson's tender offer by negotiating a "defensive merger" with Reliance (A. 78-80). Emerson then conducted an unsuccessful proxy fight against the merger (A. 125-26, 132-46, 149-54). Emerson sold 37,000 shares of its Dodge stock to Goldman, Sachs & Co. to avoid being in the position of making an involuntary "sale" through

---

[32] ". . . [T]he making of the exchange, and its timing, were simply irrelevant to the use of insider information in short-term speculation—the problem with which §16(b) is concerned. If [defendants] acted upon inside information in disposing of their stock interest when they did, the exchange was unrelated to that fact. . . ." *Blau* v. *Max Factor & Co.*, 342 F.2d 304, 309 (9th Cir. 1965).

[33] Reliance implies in its brief that the Eighth Circuit "recognized" that there was abuse *in this case*. Reliance Brief, page 13. Any fair reading of the Eighth Circuit's opinion demonstrates that this is simply not so.

the forthcoming merger, while a holder of more than 10% of Dodge's stock. It later sold its remaining Dodge stock to Dodge itself at the instance of the actual "insiders", the managements of Dodge and Reliance.

Throughout these proceedings, the hostility of the Dodge management to Emerson was demonstrable. Management fought at every turn and successfully precluded Emerson from the possibility of any access to inside information; indeed, in denying Dodge's motion for a preliminary injunction, the United States District Court for the Northern District of Indiana expressly found that Emerson had no insider information (A. 97). On the facts of *this* case, as opposed to the hypothetical facts posed by Reliance and the SEC, a holding that Emerson is liable for its second sale would not advance the remedial purposes of the Act. It would award an unconscionable windfall to the real insiders.

3. The Court Should Decide This Case On Its Facts And The Law Applicable Thereto, And Not The Parade Of Horribles Hypothesized By Reliance And The SEC.

Reliance and the SEC, straining to shore up their contention that this Court should re-write the statute, launch upon a parade of horribles which they hypothesize may result if this Court applies the statute as Congress wrote and enacted it. (Reliance Brief, page 10; SEC Brief, pp. 23-25).

Both ask this Court to accompany them on their flights of fancy, to turn its eyes from the facts of this case, to assume that all (who openly and pursuant to legal advice) seek to avoid statutory pitfalls are evil and to hold Emerson liable on the basis of nonexistent, invented "fact situa-

tions", tailor-made to lead to a conclusion of liability.[34] Further, the majority if not all of these hypothetical misdeeds would be reached by the broad remedial sanctions of Section 10(b) and Rule 10b-5.[39] Finally, if Reliance and the SEC are truly concerned with these speculated horribles, their proper recourse is to the Congress—rather than seeking, by a completely strained construction of a clearly worded statute, to impose liability upon one who acted according to the law.

In *Blau* v. *Lehman Brothers*, 368 U.S. 403, 410-11 (1962), the SEC similarly advanced a parade of horribles to persuade this Court to rewrite §16(b) to say what it does not. There, the plaintiff and the SEC contended that the statu-

---

[34] Reliance's hypothetical (Reliance Brief, page 10) assumes both access to and intentional speculative abuse of inside information; by so doing, it would avoid attempting to cope with the fact, discussed above, that *in the case at bar* there was neither the fact nor the possibility of access to insider information by Emerson.

The SEC's hypotheticals go even further afield. The first (SEC Brief, page 24) not only assumes both the possibility and the fact of access to inside information, but assumes so friendly a relationship between holder and issuing corporation that the holder can obtain inside information *prior* to any purchase of stock. The second hypothetical (SEC Brief, page 24) is not even a §16(b) hypothetical, for it is directed to "manipulative practices." The SEC's third hypothetical would assume out of the present case (as would Reliance) that a holder in Emerson's position has no possibility of access to inside information.

[35] *See* p. 20 n. 13 *supra*. Even the SEC recognizes that this focus by the district court and Reliance upon the intent with which Emerson made its first sale is in conflict with the "Congressional desire that Section 16(b) operate as objectively and automatically as possible." SEC Brief, page 9.

tory word "director" should be read as "partnership to which a director belongs." The Court rejected this request that it indulge in judicial legislation, saying:

> "One may agree that petitioner and the Commission present persuasive policy arguments that the Act should be broadened in this way to prevent 'the unfair use of information' more effectively than can be accomplished by leaving the Act so as to require forfeiture of profits only by those specifically designated by Congress to suffer those losses. But this very broadening of the categories of persons on whom these liabilities are imposed by the language of §16(b) was considered and rejected by Congress when it passed the Act." 368 U.S. at 411-12. (Footnote omitted.)

When asked, for the sake of prophylactic effect, to make the director liable for the total profits of Lehman Brothers, the Court said:

> " . . . [L]iability under §16(b) is to be determined neither by general partnership law nor by adding to the 'prophylactic' effect Congress itself clearly subscribed in §16(b)." 368 U.S. at 413-14.

The exemption to §16(b) is explicit. As this Court said in *62 Cases of Jam* v. *United States*, 340 U.S. 593 at 600 (1951), despite a litigant's purported "anxiety to effectuate the congressional purpose of protecting the public [the Court] . . . must take care not to extend the scope of the statute beyond the point where Congress indicated it would stop." If there are "loopholes" in the statutory fabric, the SEC should ask Congress to mend them. Emerson considered the law, and acted as the law allowed.

C. The Arguments Of "Substance Over Form" And "Fiduciary Duty" Advanced By Reliance And The SEC Do Not Warrant A Rewriting Of The Exemption Provision To Cover Emerson's Second Sale.

Reliance and the SEC advance, as legal theories by which they would have the Court move from general remedial principles to Emerson's liability for the second sale, two different arguments: "substance over form" (including the tax refinement of "step transaction") and "fiduciary duty". Neither is relevant here.[36]

---

[36] Reliance it appears, has developed an additional doctrine uniquely its own: the "consultation with counsel to ascertain the law" rule. Reliance makes the extraordinary suggestion that Emerson, because it had been advised by counsel of its legal rights with respect to §16(b), and because it thereafter made a sale fitting squarely within the exemption provision, somehow engaged in tainted conduct. Liability would *not* attach, under Reliance's theory, and the exemption *would* have applied so as to protect Emerson, had it reached the same result inadvertently. This proposition—that Emerson cannot retain the benefit of the exemption provision of §16(b) simply because it consulted and acted upon the advice of counsel—is shocking to say the least.

The courts in applying §16(b) have recognized that an insider may legally structure his affairs to avoid liability. The holder is "deemed capable of structuring his dealings to avoid any possibility of taint . . ." *Bershad* v. *McDonough*, 428 F.2d 693, 696 (7th Cir. 1970). *See also Adler* v. *Klawans*, 267 F.2d 840, 845 (2d Cir. 1959); *Stella* v. *Graham-Paige Motors Corp.*, 104 F.Supp. 957, 960 (S.D.N.Y. 1952).

As the Eighth Circuit noted, tax planning by taxpayers is a forceful analogy (A. 180). A taxpayer, knowing that he has a certain amount of money to invest, can elect to invest in tax ex-

Ignoring the fact that, for purposes of §16(b), a "transaction" is comprised of *a* purchase and *a* sale, *see* pp. 21-22 *supra,* Reliance argues that the whole of Emerson's experience in Dodge stock constitute one "transaction", the substance of which must prevail over form (Reliance Brief, pp. 23-4).

It is only in sham transactions that planned avoidance of §16(b) liability will be denied effect by the doctrine of "substance over form." *See, e.g., Bershad* v. *McDonough*, 428 F.2d 693, 697 (7th Cir. 1970); neither of Emerson's two distinct, open, independent and actual sales was a sham. At the time of Emerson's first sale, no second sale was waiting in the wings for the remaining shares. For all Emerson knew, it might have ended up with Reliance shares pursuant to the merger. Both Reliance and Goldman, Sachs & Co. acted as independent third parties in two *bona fide* and arms-length sales at separately negotiated prices. Indeed, the negotiations for the second sale were initiated by Reliance itself the day after Emerson's sale to Goldman, Sachs & Co. was reported.

The *sole* support which Reliance can cite for its theory that Emerson should be held liable on its second sale under "substance over form" principles is the opinion of the district court in this very case (Reliance Brief, pp. 23-25). Yet it was on this precise point that the Eighth

---

(Footnote continued)

empt property and escape tax altogether. He can elect to invest in property yielding depreciation deductions or depletion allowances. He may average fluctuating yearly income. He can even refuse to invest his money. Each of these alternatives results in some measure of tax avoidance. Each is completely legal. As the Court said in *Gregory* v. *Helvering*, 293 U.S. 465, at 469 (1935):

> "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted."

Circuit overruled the district court, correctly holding:

> " . . . as a matter of law that *intent as such to avoid loss of* realized profits by engaging in two independent sales not legally tied to each other and made at different times to different buyers such as these described above, *does not result in treating the two sales as one sale of the entire stock held, nor as one continuous transaction. . . .* " (A. 181-82) (Emphasis added.)

Narrowing its "substance over form" argument, Reliance invokes the "step-transaction" refinement developed for analysis of the tax consequences of multi-step transactions. Reliance Brief, pp. 25-27. Instead of addressing the plain language of the statutory provision involved here, Reliance relies upon three tax-free reorganization cases[37] and two depreciation deduction cases[38] in which the statutes and the transactions involved were demonstrably unrelated to the "sale" language of §16(b).[39]

---

[37] *Commissioner* v. *Gordon*, 391 U.S. 83 (1968); *King Enterprises, Inc.* v. *United States*, 418 F.2d 511 (Ct. Cl. 1969); *Anheuser-Busch, Inc.* v. *Helvering*, 40 B.T.A. 1100 (1939), *aff'd*, 115 F.2d 662 (8th Cir. 1940), *cert. denied*, 312 U.S. 699 (19441).

[38] *United States* v. *General Geophysical Co.*, 296 F.2d 86 (5th Cir. 1961), *cert. denied*, 369 U.S. 849 (1962); *American Bantam Car Co.* v. *Commissioner*, 11 T.C. 397 (1948), *aff'd*, 177 F.2d 513 (3d Cir., 1949), *cert. denied*, 339 U.S. 920 (1950).

[39] "[T]he courts, using the step transaction doctrine, must wrestle with *a particular statutory description*. Some transactions described by the Code almost always involve many individual events. Examples abound in the various reorganization provisions. These are normally complex transactions, requiring many individual events. Thus, when deciding whether several steps constitute integral parts of a single reorganization transaction, courts may quite willingly accept a rather loose or tenuous nexus among them as enough cement

Although Reliance asserts that the "step transaction" doctrine is "well established" in federal securities law, Reliance Brief, page 26, it cites no authority for that statement with respect to the Exchange Act, which is involved here. The three cases it does cite, all arising under the Securities Act of 1933, relate to the "step transaction" doctrine only, as Reliance concedes, in the very broadest sense; in fact, each turned on sham or fraud,[40] and none is pertinent to the facts of the case at

---

(Footnote continued)

to bind them together. *But when a court is faced with determining whether a corporation has made a 'distribution' or whether a 'sale' has occurred, it may be quite reluctant to combine several steps into one, because the statutory term with which it is dealing is normally thought of as involving a single event.*" Hobbet, *The Step Transaction Doctrine and Its Effect on Corporate Transactions*, Proceedings of the Nineteenth Annual Tulane Tax Institute 102 at 105 (H. Fuller ed. 1970). (Emphasis added.)

---

[40] In *SEC* v. *Micro-Moisture Controls, Inc.*, 148 F.Supp. 558, 562 (S.D.N.Y. 1957) *aff'd sub nom. SEC* v. *Culpepper*, 270 F.2d 241 (2d Cir. 1959), the court found that the defendants, acting in concert, were in common control with or under the control of the issuer, were therefore "an issuer", and were thus not entitled to an exemption under Rule 133. In *In re Great Sweet Grass Oils, Ltd., et al.*, 37 S.E.C. Reports 683 (1957) *aff'd*, 256 F.2d 893 (D.C. Cir. 1958), the Commission found massive "boiler room" fraud, false and misleading reports to the SEC, and repeated flagrant violations of several sections of the 1933 Act. In *In re The Crowell-Collier Publishing Co.*, Securities Act Release No. 3825, Exchange Act Release No. 5562 (1957), [1957-1961 Transfer Binder] CCH Fed. Sec.L.Rep. ¶76,539, the Commission found that a purported 'private offering' was in fact carried out with 'investment letters' which falsely represented that the 'investors' were purchasing the securities solely for investment with no present intent of further distribution.

bar. None was concerned with sales, concededly present here and so found by both courts below, which were *bona fide,* independent, to completely unrelated purchasers as a result of separate, arms-length negotiations.

There is no indication that Emerson, when its first sale of Dodge stock was completed, had any plan whatsoever—let alone a "binding commitment"—to sell its remaining Dodge stock to anyone. *See Commissioner* v. *Gordon,* 391 U.S. 83, 96-97 (1968). Emerson either was or was not a less-than-10% owner of Dodge *when the first sale was concluded.* As far as Emerson was concerned, it was "little more than a fortuity" (391 U.S. at 97) that Reliance subsequently initiated negotiations for purchase of the shares still held by Emerson. This Court should not, by straining the "step transaction" doctrine beyond all prior bounds, "hold that the essential character [of Emerson's first sale, and its §16(b) implications] . . . should remain not only undeterminable but unfixed for an indefinite and unlimited period in the future, awaiting events that might or might not happen." 391 U.S. at 96.

As a final "theory of liability", Reliance, citing Chief Judge Cardozo's familiar dictum on fiduciary duty from *Meinhard* v. *Salmon,* 249 N.Y. 458, 164 N.E. 545, 546 (1928), argues that Emerson should be held on the second sale so that the "statutory fiduciary" standard of §16(b) will be maintained (Reliance Brief, pp. 28-29).

The cited standard is irrelevant. The question is not *what* the proper fiduciary standard is, but rather *who* is a fiduciary. Reliance at bottom is saying that 'Emerson was a fiduciary *because* it was covered by §16(b)."[41] That argu-

---

[41] The fiduciary position thus created is an artificial creature of the statute. The only *true* fiduciary (such as an executor, conservator or trustee) in this case is the Dodge/Reliance management.

ment assumes the answer to the ultimate question in the case. Since Emerson by the terms of the statute was or was not covered by §16(b) at the time of its second sale, reference to the *duty* of a statutory fiduciary is pointless. As this Court said in *Blau* v. *Lehman Brothers,* 368 U.S. 403 at 409 (1962):

> "The language of §16 does not purport to impose its extraordinary liability on any 'person,' *'fiduciary' or not,* unless he or it is a 'director,' 'officer' or 'beneficial owner' of more than 10 percentum of any class of any equity security . . . . " (Emphasis added.)

At the time of the second sale Emerson was not an owner "of more than 10 per centum of" Dodge shares; it was therefore not a §16(b) fiduciary.

Contrary to Reliance's purported fears (Reliance Brief, page 29), the decision of the Court of Appeals will not allow "§16(b) fiduciaries" to make and keep profits by manipulating the form of their transactions. If they are indeed statutory fiduciaries, it will be solely because they are covered by the statute, and their profits will be fully recoverable; if they may keep their profits, it will be because they are exempt from §16(b) and, necessarily, are *not* "§16(b) fiduciaries." If they are not statutory fiduciaries under §16(b), but engage in insider overreaching or wrongdoing, they can be reached under §10(b) and Rule 10b-5.

As with its others, Reliance's final argument is without merit.

CONCLUSION

For the reasons and on the authorities set forth above, the judgment of the United States Court of Appeals for the Eighth Circuit should be affirmed.

Respectfully submitted,

ALBERT E. JENNER, JR.
WESLEY G. HALL
LYNNE E. MCNOWN
DOUGLAS C. NOHLGREN
135 South LaSalle Street
Chicago, Illinois 60603

Of Counsel:
JENNER & BLOCK

R. H. MCROBERTS
THOMAS C. WALSH
1600 Boatmen's Bank Building
St. Louis, Missouri 63102

BRYAN, CAVE,
MCPHEETERS &
MCROBERTS

Supreme Court, U.S.
FILED
OCT 22 1971

In the Supreme Court of the United States

OCTOBER TERM, 1971.

No. 70-79.

RELIANCE ELECTRIC COMPANY,
Petitioner,

v.

EMERSON ELECTRIC COMPANY,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT.

MEMORANDUM IN OPPOSITION TO MOTION OF GULF & WESTERN INDUSTRIES, INC. FOR LEAVE TO FILE BRIEF AMICUS CURIAE.

THOMAS P. MULLIGAN,
PATRICK J. AMER,
1750 Union Commerce Building,
Cleveland, Ohio 44115,

STEPHEN J. BURNS,
24701 Euclid Avenue,
Cleveland, Ohio 44117,

KENNETH S. TEASDALE,
611 Olive Street,
St. Louis, Missouri 63101,
Counsel for Petitioner.

Of Counsel:
JONES, DAY, COCKLEY & REAVIS,
ARMSTRONG, TEASDALE, KRAMER & VAUGHAN.

THE GATES LEGAL PUBLISHING CO., CLEVELAND, OHIO—TEL. (216) 621-5647

In the Supreme Court of the United States

OCTOBER TERM, 1971.

No. 70-79.

RELIANCE ELECTRIC COMPANY,

Petitioner,

v.

EMERSON ELECTRIC COMPANY,

Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT.

MEMORANDUM IN OPPOSITION TO MOTION OF GULF & WESTERN INDUSTRIES, INC. FOR LEAVE TO FILE BRIEF AMICUS CURIAE.

ARGUMENT.

I.

The motion of Gulf & Western Industries, Inc. for leave to file a brief *amicus curiae,* and the accompanying brief, are directed entirely toward the question whether the purchase by which a person becomes a 10% beneficial owner may be included as a transaction in determining Section 16(b) liability. This question is not before the Court.

1. The above question was presented to the Eighth Circuit in this case, and was resolved favorably to peti-

tioner Reliance. Respondent Emerson did not cross-petition for certiorari, and thus the portion of the decree below which was decided adversely to Emerson is not before this Court. *Alaska Industrial Bd. v. Chugach Electric Ass'n*, 356 U.S. 320 (1958); *LeTulle v. Scofield*, 308 U.S. 415 (1940).

2. The question of law involved in Emerson's purchase of shares, which is the only question to which the Gulf & Western *amicus* brief is directed, was not set forth in the "Question Presented" in the Petition for a Writ of Certiorari, nor is it a subsidiary question fairly comprised therein. Supreme Court Rule 23(1)(c) provides that: "Only the questions set forth in the petition or fairly comprised therein will be considered by the court." Supreme Court Rule 40(1)(d)(2) provides that the brief of petitioner may not raise additional questions or change the substance of the questions already presented; and Supreme Court Rule 42(5) strongly implies that a brief *amicus curiae* is subject to the same restriction.

3. Neither of the parties to the case has argued the question whether Section 16(b) applies to the purchase by which a person becomes a 10% beneficial owner.

II.

Although petitioner believes, for the foregoing reasons, that a response on the merits to the argument made in Gulf & Western's brief *amicus curiae* is neither required nor appropriate, petitioner notes the following:

1. The key to the argument from legislative history in Section 1 of the *amicus* brief is the assertion that Senate Bill No. 3420, introduced on April 27, 1934, did not contain the exemption clause applicable to 10% beneficial owners, and did not contain the preamble presently found

in Section 16(b). This assertion appears to be based on the belief that Senate Bill No. 3420 was reprinted or set forth in Senate Report No. 792, 73d Cong., 2d Sess. (1934). In fact, Senate Report No. 792 did not set forth the text of Senate Bill No. 3420, but simply contains a summary of the bill by sections. The version of Section 16(b) set forth in Senate Bill No. 3420 itself does contain the preamble *and* the 10% beneficial owner exemption, both in the precise language of Section 16(b) as finally enacted. It follows, we believe, that the distinction made in the brief *amicus curiae* between manipulative ability and mere informational access, a distinction based on this erroneous reading of Senate Bill No. 3420, is without foundation.

2. The brief *amicus curiae* argues that Section 16(b) is not directed toward the possibility of abuse of inside information acquired after the purchase but before the sale, because the measure of liability imposed by Section 16(b) may not in such an instance correspond to the measure of gain derived from use of such inside information. The brief *amicus curiae* suggests that Section 16(b) should apply only to those 10% beneficial owners who can be proved to have exercised control over the issuer. Both questions are discussed, and, we submit, sufficiently answered, in Judge Learned Hand's analysis in *Gratz v. Claughton*, 187 F.2d 46, 50-52 (2d Cir.), *cert. denied*, 341 U.S. 920 (1951), the first reported decision of a United States Court of Appeals involving a 10% beneficial owner.

III.

In the event that the Court should decide on its own motion to consider the question of the applicability of Section 16(b) to the purchase by which a person becomes a 10% beneficial owner, petitioner Reliance would appre-

ciate the opportunity to submit a brief in support of that portion of the decision of the Eighth Circuit.

Respectfully submitted,

THOMAS P. MULLIGAN,
PATRICK J. AMER,
1750 Union Commerce Building,
Cleveland, Ohio 44115,

STEPHEN J. BURNS,
24701 Euclid Avenue,
Cleveland, Ohio 44117,

KENNETH S. TEASDALE,
611 Olive Street,
St. Louis, Missouri 63101,
Counsel for Petitioner.

Of Counsel:

JONES, DAY, COCKLEY & REAVIS,
ARMSTRONG, TEASDALE, KRAMER & VAUGHAN.

Supreme Court, U.S.
FILED
OCT
ERC

In the Supreme Court of the United States

OCTOBER TERM, 1971.

No. 70-79.

RELIANCE ELECTRIC COMPANY,
Petitioner,

v.

EMERSON ELECTRIC COMPANY,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT.

REPLY BRIEF FOR PETITIONER.

THOMAS P. MULLIGAN,
PATRICK J. AMER,
1750 Union Commerce Building,
Cleveland, Ohio 44115,

STEPHEN J. BURNS,
24701 Euclid Avenue,
Cleveland, Ohio 44117,

KENNETH S. TEASDALE,
611 Olive Street,
St. Louis, Missouri 63101,
Counsel for Petitioner.

Of Counsel:

JONES, DAY, COCKLEY & REAVIS,
ARMSTRONG, TEASDALE, KRAMER & VAUGHAN.

THE GATES LEGAL PUBLISHING CO., CLEVELAND, OHIO—TEL. (216) 621-5647

TABLE OF CONTENTS.

ARGUMENT ---------- 1

I. The Question Presented Is Whether Emerson's Two-Step Sale Procedure Is To Be Approved as a Method for Avoiding Section 16(b) Liability -- 1

II. The Terms "Sale" and "At the Time of Sale" as Used in Section 16(b) Should be Construed With a View to the Purpose of Section 16(b) ----- 5

III. Emerson's Disposition of Dodge Stock Through the Two-Step Sale Procedure Lent Itself to the Speculation Encompassed by Section 16(b) ---- 8

CONCLUSION ---------- 10

TABLE OF AUTHORITIES.

Cases.

Abrams v. Occidental Petroleum Corp., Docket Nos. 71-1273-76, 2d Cir., October 13, 1971, reversing 323 F. Supp. 570 (S.D.N.Y. 1971) ---------- 6

Ferraiolo v. Newman, 259 F.2d 342 (6th Cir. 1958), *cert. denied*, 359 U.S. 927 (1959) ---------- 8

Magida v. Continental Can Co., 231 F.2d 843 (2d Cir.), *cert. denied*, 351 U.S. 972 (1956) ------ 8

SEC v. Micro-Moisture Controls, Inc., 148 F. Supp. 558 (S.D.N.Y. 1957), *affirmed sub nom. SEC v. Culpepper*, 270 F.2d 241 (2d Cir. 1959) ------ 5

SEC v. National Securities, Inc., 393 U.S. 453 (1969) 7

Smolowe v. Delendo Corp., 136 F.2d 231 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943) ---------- 8

Statutes.

Securities Exchange Act of 1934:

Sec. 16(a) ---------- 4

Sec. 16(b) ---------- 1, *et passim*

Other.

Meeker & Cooney, "The Problem of Definition in Determining Insider Liabilities Under Section 16(b)," 45 *Va. L. Rev.* 949 (1959) ---------- 6

Uniform Commercial Code, Section 2-106(1) ---------- 5

In the Supreme Court of the United States

OCTOBER TERM, 1971.

No. 70-79.

RELIANCE ELECTRIC COMPANY,

Petitioner,

v.

EMERSON ELECTRIC COMPANY,

Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT.

REPLY BRIEF FOR PETITIONER.

ARGUMENT.

I. THE QUESTION PRESENTED IS WHETHER EMERSON'S TWO-STEP SALE PROCEDURE IS TO BE APPROVED AS A METHOD FOR AVOIDING SECTION 16(b) LIABILITY.

The central issue in the instant case requires a careful distinction between the following two situations:

Case I: A 10% beneficial owner, while enjoying insider status, determines to dispose of shares of the issuer, acquired when he was a 10% beneficial owner, at a profit, and carries out this decision by selling those shares within less than six months of their purchase. Section 16(b) clearly requires that such profit inure to the issuer. The particular technique

of disposition used to carry out the decision to dispose of the shares should not affect this result.

Case II: A former 10% beneficial owner, after he has ceased enjoying insider status, determines to dispose of shares of the issuer, acquired when he was a 10% beneficial owner, at a profit, and carries out this decision by selling those shares within less than six months of their purchase. Whether Section 16(b) requires that such profit inure to the issuer is arguable; the SEC maintains that it should, and Emerson maintains that it should not. The particular technique of disposition used to carry out the decision to dispose of the shares is in the view of neither the SEC nor Emerson a significant factor.

The reason why the applicability of Section 16(b) is arguable in Case II, but certain in Case I, is that the 10% beneficial owner in Case II has assumed some period of investment risk as an outsider, and, as his decision to sell was formulated after he relinquished insider status, it cannot be presumed that the consequent sale was based upon inside information or made by reason of the shareholder's relationship to the issuer. In Case I, however, the 10% beneficial owner has decided not to assume for any significant period the investment risk of an outsider, and has made his decision to sell at a time when Section 16(b) irrebuttably presumes the availability and use of inside information. A decision by the 10% beneficial owner in Case I, made while an insider, to dispose of stock in two sale transactions is indistinguishable, in its potential for unfair use of inside information, from a decision made at such time to dispose of the same stock in one sale transaction, to which Section 16(b) clearly applies.

The facts in the case at bar correspond to those in Case I, not to those in Case II. In its brief, however, Emerson asserts that the instant case is Case II, and Emerson's major arguments are directed toward the question of how Section 16(b) applies to Case II. To make such an argument, Emerson's brief makes factual assertions directly contrary to the facts as found by the District Court below and as accepted by the Eighth Circuit Court of Appeals. A parallel comparison shows how Emerson has departed, in crucial respects from the facts in this case:

Emerson's Assertions	The District Court's Findings
"There is no dispute that the first sale was made because Emerson feared that the forthcoming Reliance-Dodge merger, which it had opposed, would result in an *involuntary* "sale" of Emerson's stock within the meaning of § 16 (b)." (Emerson Br. p. 22; emphasis Emerson's.)	"Emerson's initial sale of 37,000 shares was motivated *solely* by its desire to reduce its holding to just under 10% immediately prior to disposing of the balance of its shares in an attempt to escape Section 16(b) liability on the short-swing profits it contemplated would be made upon such remaining shares." (A. 163; emphasis added.)
"The second sale, *i.e.*, the sale to Dodge, was *concededly not anticipated* at the time of the first sale, and was initiated by Reliance, not Emerson." (Emerson Br. p. 22; emphasis Emerson's.)	"That the negotiations with Reliance for the sale of the Emerson-held Dodge shares were initiated by Reliance does not affect our conclusion that the two sales were in fact interrelated parts of a single plan. In fact, in his June 26 letter, Emerson's counsel *had anticipated* the possibility of a settlement under a negotiated agreement providing for the purchase of the Dodge shares owned by Emerson . . . ." (A. 164; emphasis added.)

Emerson's Assertions	The Eighth Circuit's View
"There is no indication that Emerson, when its first sale of Dodge stock was completed, had any plan whatsoever—let alone a 'binding commitment' —to sell its remaining Dodge stock to anyone." (Emerson Br. p. 40.)[1]	"The District Court found that while Emerson was the beneficial owner of 13.2 percent of Dodge shares it determined to dispose of *its entire stock holdings pursuant to a plan* whereby it hoped to avoid, to the extent possible, Section 16(b) liability for short term profits. *Pursuant to that determination* it made the mentioned two separate sales not tied in any legal way to each other." (A. 180; emphasis added.)

Emerson's attempt to change the facts from the Case I pattern to the Case II pattern appears in its brief not only in the portions quoted above, but throughout. Thus, Emerson has restated the "Question Presented" to present the Case II problem; and assertions of fact substantially equivalent to those quoted above appear on pages 8, 32 and 37. Emerson's version of the facts underlies much of its legal argument, for none of the authorities discussed by Emerson at pages 13-16 discuss the application of Section 16(b) to a "single pre-determined plan of disposition" (A. 163) formulated by a 10% beneficial owner when an insider and carried out through the technique of two sales. Similarly, the application of Section 16(a) to the two-step

---

[1] Emerson's statement to the Eighth Circuit below belies its assertion here:

> "Thereupon, with the Dodge-Reliance merger upcoming, *Emerson concluded* that, rather than remain a stockholder of Dodge and accept the securities of Reliance pursuant to the Dodge-Reliance merger, *it would undertake to dispose of its 152,282 shares* of Dodge stock in two separate and distinct transactions—first a sale of 37,000 shares, reducing its holdings to less than 10%, and second a sale of the balance." (A. 168; emphasis added.)

sale procedure has not been determined, and Emerson's argument at pages 17-18 bears only on the Case II pattern. Emerson's refusal to address its arguments to the "two-step sale procedure" (the District Court's phrase, A. 164) or to the Case I factual pattern presented by the record accurately reflects, we submit, the paucity of arguments available to support the decision of the Eighth Circuit on this point.

II. THE TERMS "SALE" AND "AT THE TIME OF SALE" AS USED IN SECTION 16(b) SHOULD BE CONSTRUED WITH A VIEW TO THE PURPOSE OF SECTION 16(b).

Emerson's argument, and the decision of the Eighth Circuit, both rely in large part on the assertion that Emerson made "two independent sales." There is a semantic problem here, arising from the confusion of two bodies of law. The term "sale" is a term of contract law and commercial law. A determination whether a given factual pattern presents one sale or two sales is made by counting the number of occasions of passage of title. *Cf.* Uniform Commercial Code, Section 2-106(1). From the view of commercial law, Emerson made two "sales," and its two sales were, as a matter of commercial law, separate and independent.[2]

The unspoken assumption of Emerson's argument, and that of the Eighth Circuit, is that the commercial law

---

[2] Because the sales were valid commercial transactions, neither was a "sham." In the same sense, the exchange of Micro-Moisture stock for Converters' assets in *SEC v. Micro-Moisture Controls, Inc.*, 148 F. Supp. 558 (S.D.N.Y. 1957), *affirmed sub nom. SEC v. Culpepper*, 270 F.2d 241 (2d Cir. 1959), was presumably a valid corporate transaction; the court does not suggest otherwise. The failure to register the stock so issued in no sense rendered the issuance a "sham." Neither the step transaction doctrine nor the substance over form principle is limited to cases of sham or fraud, as Emerson asserts. See Brief for Petitioner, pp. 24-27.

concept of "sale" is determinative. If this were so, most of the cases which have arisen under Section 16(b) since its enactment would have been wrongly decided, since by far the most frequently arising question under Section 16(b) has been the interpretation of the words "purchase" and "sale" in the light of the statutory purpose of Section 16(b). See cases cited in Brief for Petitioner, pp. 19-22; Meeker & Cooney, "The Problem of Definition in Determining Insider Liabilities Under Section 16(b)," 45 *Va. L. Rev.* 949, 958 *ff.* (1959).

The recent decision in *Abrams v. Occidental Petroleum Corp.*, Docket Nos. 71-1273-76, 2d Cir., October 13, 1971, reversing the District Court decision cited in both briefs and reported at 323 F. Supp. 570 (S.D.N.Y. 1971), illustrates the uniform standard of construction applied by courts. As Chief Judge Friendly makes clear, the determination whether a given transaction constitutes a "purchase" or "sale" depends on whether the transaction "could have lent itself to speculative abuse." Slip Opinion, p. 75. The Second Circuit held that the merger of Kern County Land Co. into a subsidiary of Tenneco Corp. did not constitute a "sale" of Occidental's Kern County shares, because the possibility of speculative abuse was not present;[3] and that the option granted by Occidental to Tenneco did not constitute a "sale" under Section 16(b).

Reliance is thus not seeking an extension of Section 16(b), or a "remedial" construction of the statute at variance with the standards of construction always held

---

[3] Under the Second Circuit's decision in *Occidental*, the exchange of Emerson's Dodge shares for Reliance shares in the Dodge-Reliance merger would probably not have constituted a "sale" for Section 16(b) purposes. As Emerson did not hold its Dodge shares until the merger closed, but instead sold them for cash, the *Occidental* decision is of no help to Emerson.

applicable under Section 16(b). Reliance simply asks for application of the general rule that the words "sale" and "at the time of sale," whatever they may mean in other contexts, be here construed in the context of the statutory purpose of Section 16(b). *Cf. SEC v. National Securities, Inc.*, 393 U.S. 453, 466-67 (1969). In the light of Section 16(b), it simply cannot be said that Emerson made "*two totally independent sales.*" (Emerson Br. p. 23; emphasis Emerson's.) The facts as found by the District Court show unquestionably that the two sales were united in intent and purpose as "interrelated parts of a single plan." (A. 164.)

Whether Emerson's two sales are held to be subject to Section 16(b) by treating them as one "sale" as the term is used in Section 16(b), or whether the same result is reached by construing the phrase "at the time of sale" to include the entire period during which the series of related transactions took place, as the District Court did, is a matter of choice for this Court. We point out, however, that even Emerson appears to recede from its argument that the statutory terms are unambiguous in the latter respect, for while it argues that the words "at the time of sale" are unambiguous, it concedes that the words "at the time of purchase" are "arguably ambiguous" and were regarded as ambiguous by the Court of Appeals. Emerson Br. pp. 27, 30.

III. EMERSON'S DISPOSITION OF DODGE STOCK THROUGH THE TWO-STEP SALE PROCEDURE LENT ITSELF TO THE SPECULATION ENCOMPASSED BY SECTION 16(b).

At pages 31-33 of its brief, Emerson attempts to argue that it was not in fact privy to inside information as a shareholder of Dodge. At pages 33-35 Emerson seeks to dismiss the question whether the factual pattern of Emerson's transactions created the possibility of abuse of Section 16(b) as a "parade of horribles hypothesized." The law is to the contrary.

Whether Emerson actually used inside information, or whether inside information was available to Emerson, is entirely irrelevant to the applicability of Section 16(b).[4] *Smolowe v. Delendo Corp.*, 136 F.2d 231, 235-36 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943); *Ferraiolo v. Newman*, 259 F.2d 342, 344 (6th Cir. 1958), *cert. denied*, 359 U.S. 927 (1959). The question which Section 16(b) requires a court to ask is whether, if inside information had been available, the transactions in question would have been apt vehicles for taking short-term profits on that information. It is obvious that, if Emerson had obtained inside information from Dodge immediately prior to its decision to dispose of its 152,282 shares of Dodge, possession of that information would have given Emerson precisely the kind of unfair advantage over other Dodge shareholders and the investing public which Section 16(b) was designed to prevent, and that both of Emerson's sales constituted apt vehicles for profiting on the inside information which the statute presumes was present.

Even if Emerson's protestations of innocence were

---

[4] Equally irrelevant are the prior opinions and beliefs of Reliance and its counsel, and the fact that Reliance participated in Emerson's sale to Dodge. *Magida v. Continental Can Co.*, 231 F.2d 843, 846-47 (2d Cir.), *cert. denied*, 351 U.S. 972 (1956).

relevant, which they are not, they are not borne out by the record. As the Eighth Circuit observed: "An insider engaged in a contest for control of its stock issuer may have substantial opportunity for short-term profits perforce of its substantial stock ownership." (A. 179.) Consider Emerson's dealings. Just *prior* to its purchase on June 16, 1967, Emerson's board authorized an agreement of merger with Dodge. This offer to merge was first revealed to Dodge on June 17, the day after Emerson purchased 152,282 Dodge shares at $63 per share, and first revealed to the general public the following Monday. (Plaintiff's Exhibits 16 and 17, A. 104-07.) Emerson maintained the credibility of its merger offer by engaging in litigation and in a vigorous proxy contest with Reliance. (Plaintiff's Exhibits 24-31, A. 125-54.) Throughout the contest, Emerson attempted to convince the Dodge shareholders that its merger offer was worth substantially more to them than $63 per share. ($74.25 and $81.56 were the per-share values claimed by Emerson in Plaintiff's Exhibits 27 and 30, A. 132, A. 151.) Emerson must have known that its merger offer would have an effect on the market for Dodge shares which would create and maintain a substantial opportunity for short-term profits for Emerson. When Emerson learned that the Reliance merger had been approved by the Dodge shareholders, Emerson decided to withdraw from the contest for control of Dodge. Since Emerson's merger offer would thereafter no longer exert a significant upward pressure on the market price of Dodge stock, Emerson determined to take its partially self-generated short-term profit by promptly disposing of all its Dodge stock. Emerson did so, and took its profit. Reliance submits that it would be contrary to the spirit as well as to the letter of Section 16(b) to permit Emerson to retain such profit.

CONCLUSION.

For the reasons stated above and in the Brief for Petitioner, the Court should reverse the judgment of the Eighth Circuit Court of Appeals on Emerson's second sale.

Respectfully submitted,

THOMAS P. MULLIGAN,
PATRICK J. AMER,
1750 Union Commerce Building,
Cleveland, Ohio 44115,

STEPHEN J. BURNS,
24701 Euclid Avenue,
Cleveland, Ohio 44117,

KENNETH S. TEASDALE,
611 Olive Street,
St. Louis, Missouri 63101,
Counsel for Petitioner.

Of Counsel:

JONES, DAY, COCKLEY & REAVIS,
ARMSTRONG, TEASDALE, KRAMER & VAUGHAN.

SUPREME COURT, U. S.

Supreme Court, U.S.
FILED
NOV 5 1971
ROBERT SEAVER, CLERK

In The

Supreme Court of the United States

OCTOBER TERM 1971

No. 70-79

RELIANCE ELECTRIC COMPANY,

Petitioner,

v.

EMERSON ELECTRIC COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

REPLY MEMORANDUM OF GULF & WESTERN INDUSTRIES, INC. IN SUPPORT OF ITS MOTION FOR LEAVE TO FILE A BRIEF AS AMICUS CURIAE

WHITNEY NORTH SEYMOUR,
One Battery Park Plaza,
New York, New York 10004,
Counsel for Gulf & Western Industries, Inc.

Of Counsel:
JOHN A. GUZZETTA,
BERNHARDT K. WRUBLE,
Simpson Thacher & Bartlett.

INDEX

	PAGE
Statement	1
Argument	1
Conclusion	6

Citations

Cases:

Adler v. *Klawans*, 267 F.2d 840 (2 Cir. 1959)	4
Blau v. *Lehman*, 368 U.S. 403 (1962)	4
Blau v. *Lamb*, 363 F.2d 507 (2 Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967)	4
Gratz v. *Claughton*, 187 F.2d 46 (2 Cir.), *cert. denied*, 341 U.S. 920 (1951)	5
Petteys v. *Butler*, 367 F.2d 528 (8 Cir. 1966), *cert. denied*, 385 U.S. 1006 (1967)	4

Statutes:

Section 16(b) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. 78p(b)	4

Miscellaneous:

Hearings before the Senate Committee on Banking and Currency, 73d Cong., 1st and 2d Sess.	4
H. R. 8720, 73d Cong., 2d Sess.	3, 6
H. R. 9323, 73d Cong., 2d Sess.	6
2 Loss, *Securities Regulation* (2 Ed. 1961)	5
5 Loss, *Securities Regulation* (2 Ed. Supp. 1969)	4
Senate Bill No. 3420, 73d Cong., 2d Sess.	2
Senate Report No. 792, 73d Cong., 2d Sess.	2
Senate Report No. 1455, 73d Cong., 2d Sess.	3, 5

In The

Supreme Court of the United States

OCTOBER TERM 1971

No. 70-79

RELIANCE ELECTRIC COMPANY,

Petitioner,

v.

EMERSON ELECTRIC COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

REPLY MEMORANDUM OF GULF & WESTERN INDUSTRIES, INC. IN SUPPORT OF ITS MOTION FOR LEAVE TO FILE A BRIEF AS AMICUS CURIAE

Statement

This memorandum is submitted in reply to the "Memorandum in Opposition to Motion of Gulf & Western Industries, Inc. for Leave to File Brief Amicus Curiae," submitted by petitioner (hereinafter "Opposition Memorandum").

Argument

I.

We do not take issue with petitioner's description of the procedural posture of this case (Opposition Memorandum, pp. 1-2). As stated in our moving papers, the pur-

pose of our motion is one to guard against the possibility that the Securities and Exchange Commission ("SEC"), through its formulation of the "Question Presented," might persuade the Court to adjudicate an issue which was not the subject of a petition for certiorari and which has not been tendered or briefed by either party. Resolution of such an important issue, arising in contexts scarcely envisioned by the 73d Congress, should, we believe, await a case where it is the subject of arguments by the parties immediately concerned, and be decided by this Court only after the refinement of such arguments which may be expected in the lower and intermediate courts.

II.

1. The Opposition Memorandum points to an inadvertent error in our proposed brief *amicus curiae*, in that we did not believe that Senate Bill No. 3420 contained the exemption applicable to 10% beneficial owners.* Rectification of this error does not, however, dilute the showing that Section 16(b) was designed to attack the misuse of inside information, and that its automatic application on the questionable basis of hypothesized manipulation must be justified by a defendant's official status.

As indicated at pages 12-13 of our proposed brief, we had anticipated the possibility that if Senate Bill No. 3420 did not contain an exemption for 10% beneficial owners, it might be argued that the Senate intended to impute identical abilities to 10% beneficial owners as to officers and directors. It now appears that Senate Bill No. 3420, introduced in April 1934, did in fact adopt both of the exemp-

* Such error was based upon the failure of Senate Report 792, 73d Cong., 2d Sess. (1934) to mention the addition of the exemption for 10% shareholders, and an apparent break in our own verification procedures during our attempt to assemble materials relating to the legislative history of the subsection, which we regret.

tions first presented in the House bill, H.R. 8720* introduced in March 1934. Thus, the argument which we attempted to anticipate and answer could not in fact properly be made. Rather it would appear that the Senate bill was in fact responsive to the objections raised by Senator Kean to identical treatment of official and non-official "insiders" set forth at pages 8-9 of our proposed brief—which the SEC's argument ignores—and that such a response was not, as we had believed, a last minute compromise in the conference committee.

Indeed, we note that Senate Report No. 1455, 73d Cong., 2d Sess. (1934) draws a distinction between the abilities attributed to official and non-official insiders. It is there stated that the evidence before the subcommittee showed:

> the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust *and* the confidential information which came to them in such positions, to aid them in their market activities. (*Id.* at p. 55; emphasis added.)

The practices of large shareholders were not stated to be identical to those of corporate officials, but were limited to the use of inside information:

> Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of their

---

* The portion of H.R. 8720 which contained the two exemptions, and the language (separated by italics) which became the preamble of Senate Bill No. 3420, reads as follows:

> "This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale or sale and purchase of the security involved, nor any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection *of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer.*"

companies to enable them to acquire and profit by information not available to others. *Ibid.*

Moreover, reluctance to impose "automatic" liability on shareholders on the basis of hypothesized manipulation without regard to the circumstances of a particular case should follow directly from the fact that such a basis goes beyond the expressly stated scope of the statute. See *Adler* v. *Klawans,* 267 F.2d 840, 846-847 (2d Cir. 1959); cf. *Blau* v. *Lehman,* 368 U. S. 403, 413-414 (1962). The text of the statute identifies its target, without ambiguity, as the "unfair use of information" which may have been obtained by reason of a "relationship to the issuer"—not manipulation nor other kinds of knowledge which are not derived from such a relationship.

We are moved from the statement in our proposed brief (pp. 9-10) that an absence of the exemption for 10% beneficial owners in Senate Bill No. 3420 demonstrates that such exemption was intended to deal with a problem other than that suggested by the SEC. Nevertheless, it remain evident that the specialized exemption for 10% beneficial owners was not structured to cover the diverse problems that might arise in connection with such matters as the administration of fiduciary accounts and non-consensual changes in ownership. Rather, the other exemptive provision—the general power granted to the SEC to exempt transactions "not comprehended within the purpose of this subsection."* —of which the SEC's argument takes no account, is structured to meet the range of such situations with special equities and parallels the language used by Mr. Corcoran in the Senate committee hearings relating to one such problem of fiduciaries as not within the "intention" of Section 16(b).**

---

* This exemptive power has been held to be equally open to the courts. See *Pettys* v. *Butler,* 367 F.2d 528, 536 (8 Cir. 1966), *cert. denied,* 385 U. S. 1006 (1967); *Blau* v. *Lamb,* 363 F.2d 507, 519 (2 Cir. 1966), *cert. denied,* 385 U. S. 1002 (1967); 5 Loss, *Securities Regulation,* pp. 3038-9 (2 Ed. Supp. 1969).

** Hearings before the Senate Committee on Banking and Currency, 73d Cong., 1st & 2d Sess. (1934), p. 6558.

2. Of the several reasons set forth at pages 18-24 of our proposed brief showing that Section 16(b) was not designed to deal with hypothesized abuses based solely on "after-acquired information," petitioner directs its response to only one, *viz.*: our showing that Section 16(b) is inherently structured so that it cannot measure a profit based solely upon the hypothetical use of after-acquired information and that, if so applied, it will yield irrational results. Petitioner erroneously suggests that this objection was answered by Judge Learned Hand in *Gratz* v. *Claughton*, 187 F.2d 46, 50-52 (2d Cir.), *cert. denied*, 341 U. S. 920 (1951). In that case, the court was *not* dealing with the question of whether Section 16(b) should properly apply in light of the statutory exemption, which is the question involved here. Rather, the court, in assessing the constitutionality of the statute, merely addressed the broad suppositions* upon which Congress might have acted in including large stockholders within Section 16(b) in the first instance. In addition, the court dealt with the issue of what rule of damage computation should be employed *after* it had been determined that Section 16(b) was applicable. Judge Hand adopted a lowest-in, highest-out ("LIHO") rule of damage computation because the court could find no other method of computation to protect against the ability of a defendant who had an inventory of shares to shift transactions in a way that would minimize, or make it appear that there was no, "profit." *Ibid.*; see 2 Loss, *Securities Regulation*, 1062-1064 (2 ed. 1961).

It is clear that the LIHO damage rule does not purport to charge the defendant with a "profit" which cannot bear a logical relationship to his possible use of inside information, as would the after-acquired information theory. The

---

* As indicated in Senate Report No. 1455, *supra* pp. 3-4, the "control" laid to large shareholders was merely in the sense of control sufficient to acquire inside information.

LIHO rule seeks merely to insure that a profit which does bear such a relationship cannot, by clever arrangement of the transactions, be obscured.

3. Through the courtesy of the government, we have been provided with a pre-proof copy of a "Supplemental Brief" proposed to be submitted by the SEC. While we believe that the core arguments of the SEC have been met in the foregoing text, it should be carefully pointed out that the selected quotations from floor speeches of certain members of the House set forth near the close of that brief do not in any way relate to the present Section 16(b). The bill to which that broad language was addressed was H.R. 9323, which did not contain any provision for the recapture of short-swing profits.

In addition, we must point out that our proposed brief did not state, as the SEC contends, that the language of the preamble appeared only in the House version of the present Section 16(b). We stated merely (p. 10, n 6) that it had first been introduced in H.R. 8720, which the SEC appears to confirm.

CONCLUSION

The judgment of the court below should be affirmed insofar as it adjudged respondent not to be liable under Section 16(b).

Respectfully submitted,

WHITNEY NORTH SEYMOUR,
One Battery Park Plaza,
New York, New York 10004.
Counsel for Gulf & Western Industries, Inc.

Of Counsel:
JOHN A. GUZZETTA,
BERNHARDT K. WRUBLE,
Simpson Thacher & Bartlett.

LIBRARY
SUPR... U. S.

Corrected copy

Supreme Court, U.S.
FILED
NOV 6 1971
E. ROBERT SEAVER, CLERK

No. 70-79

In the Supreme Court of the United States

OCTOBER TERM, 1971

RELIANCE ELECTRIC COMPANY, PETITIONER

v.

EMERSON ELECTRIC COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

SUPPLEMENTAL BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

ERWIN N. GRISWOLD,
Solicitor General,
SAMUEL HUNTINGTON,
Assistant to the Solicitor General,
Department of Justice,
Washington, D.C. 20530.

G. BRADFORD COOK,
General Counsel,
WALTER P. NORTH,
Associate General Counsel,
JACOB H. STILLMAN,
Assistant General Counsel,
FREDERIC T. SPINDEL,
Attorney,
Securities and Exchange Commission,
Washington, D.C. 20549.

In the Supreme Court of the United States

OCTOBER TERM, 1971

No. 70–79

RELIANCE ELECTRIC COMPANY, PETITIONER

v.

EMERSON ELECTRIC COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

SUPPLEMENTAL BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

Subsequent to the submission of our main brief, Gulf & Western Industries, Inc. ("Gulf & Western") moved to file an *amicus curiae* brief on the question whether the purchase by which a person becomes a 10 percent beneficial owner is to be included within the coverage of Section 16(b) as the first of a pair of transactions of purchase and sale occurring within the six-month period. Although apparently agreeing with the parties that this issue is not before the Court—it was decided by the court below in favor of petitioner Reliance Electric Company and respondent Emerson Electric Company did not cross-petition for

448-714—71

certiorari—Gulf & Western has submitted its brief on the ground that the discussion of the issue in our main brief invites this Court to adjudicate it.

While we agree that Section 16(b)'s application to Emerson's initial purchase of Dodge stock need not as such be resolved by this Court, a comprehensive analysis of all the insider abuses that Section 16(b) was designed to curb and a determination whether Emerson's two sales of Dodge stock could have enabled Emerson to profit from such abuses requires that some consideration be given to the "purchase" component of the exemptive provision of the statute. Since the starting point of such an analysis is the legislative history of Section 16(b) and its exemptive provision and since Gulf & Western has inaccurately portrayed that legislative history, we deem it appropriate to file this response.

1. In our main brief (pp. 29–32), we expressed the view that the exemptive provision in Section 16(b) evidences a legislative intent to accord different treatment to 10 percent beneficial owners than to officers and directors, in recognition that, while the latter can become statutory insiders only by voluntarily assuming the position of officer or director of a corporation, a 10 percent beneficial owner may attain or lose such statutory insider status by events other than a purchase or sale of stock. On this basis, we urged a construction under which the exemption would not be applicable in situations where insider status is acquired or lost by a stock purchase or sale, but instead would be applicable only in situations where, for ex-

ample, a person's stockholdings in a corporation are increased to more than 10 percent through the purchase by the corporation of part of its outstanding securities or through an acquisition of stock (other than by purchase) incidental to service as a fiduciary. In support of our position, we noted (pp. 32–34) that H.R. 8720, 73d Cong., 2d Sess., a substitute bill containing the exemptive provision for beneficial owners, was introduced in the House (on March 19, 1934) shortly after specific criticism was expressed at the Senate hearings (on February 28, 1934) concerning the adverse effect the initial draft of Section 16(b) might have upon executors, trustees and other fiduciaries.[1] This adverse effect on fiduciaries, arising from the possible attainment of 10 percent beneficial owner status through acquisition of stock other than by purchase, is simply an example of the adverse effect Section 16(b), absent the exemptive provision, would have on beneficial owners generally.

Gulf & Western, however, disputes our view. It contends that the legislative history of Section 16(b) demonstrates that the exemption for beneficial owners could not have been in response to the criticism concerning fiduciaries expressed at the Senate hearings, and thus was not intended to deal with problems of

[1] In attributing a direct connection between the inclusion of the exemptive provision in H.R. 8720 and the criticism expressed at the Senate hearings, we gave recognition to the fact that the Senate and House draftsmen were coordinating their efforts. See Hearings Before the House Committee on Interstate and Foreign Commerce on H.R. 7852 and H.R. 8720, 73d Cong., 2d Sess., pp. 82–83.

fiduciaries, since that exemption "was not included in any Senate draft" of Section 16(b) (Br. 10). Specifically, Gulf & Western states that the exemptive provision, although contained in the House bill (H.R. 8720), did not appear in S. 3420, 73d Cong., 2d Sess.,[2] a substitute bill introduced in the Senate at the close of the Senate hearings at which Section 16(b)'s effect on fiduciaries was discussed. Contrary to Gulf & Western's contention, however, S. 3420, like H.R. 8720, did contain the exemptive provision for beneficial owners which now appears in the statute.[3]

2. Gulf & Western next attempts to explain the different treatment which the exemption accords 10 percent beneficial owners on the basis of a distinction which attributes both access to inside information and manipulative ability to officers and directors, but only access to information to large shareholders.

Specifically, Gulf & Western argues (Br. 12–13) that it was the House version of Section 16(b) that was ultimately enacted into law, and that, although the Senate apparently viewed its draft of Section 16(b), contained in S. 3420, as designed both to deal with unfair use of inside information and to prevent insiders from manipulating the financial affairs of their corporations, the House, on the other hand, con-

[2] S. 3420 was introduced in the Senate on April 20, 1934, not on April 27, 1934, as stated by Gulf & Western. See 78 Cong. Rec. 6980.

[3] Gulf & Western's mistaken belief that the exemption did not appear in S. 3420 is apparently based on the notion that S. 3420 was reprinted in full text in S. Rep. No. 792, 73d Cong., 2d Sess. That report, however, contained only a summary of the bill by sections and did not reprint the text of the bill. See S. Rep. No. 792, 73d Cong., 2d Sess., pp. 14, 20–21.

sidered its version of the statute as principally a means to combat the unfair use of inside information (Br. 10, 11). Based on the assumption that the exemption for beneficial owners appeared only in the House version of the statute, Gulf & Western concludes that the exemption, as enacted, was intended to exclude 10 percent beneficial owners from the purview of whatever antimanipulative effect Section 16(b) was designed to have.

Gulf & Western's entire analysis, however, rests on a series of erroneous assumptions and conclusions. First, as we have pointed out, both S. 3420 and H.R. 8720, contained the exemptive provision. Gulf & Western also is in error in stating that the preamble of Section 16(b), setting forth the statutory purpose as the prevention of unfair use of inside information, was contained only in the House version of the bill and thus reflected a narrower view by the House with respect to the statute's antimanipulative purpose. In fact, a preamble also was contained in S. 3420, where it appeared in the precise language of Section 16(b) as finally enacted. Moreover, there is no inconsistency between the statutory purpose set forth in the preamble and the concept that Section 16(b) was intended to prevent corporate manipulation by insiders. A person's knowledge that he will manipulate a corporation's affairs is no less information that Congress intended to deal with in Section 16(b) than his knowledge of what the corporation plans to do.

Also inaccurate is Gulf & Western's suggestion that only the Senate considered the problem of manipulation of corporate affairs by insiders, including large

shareholders.[4] Floor debates in the House on an amendment to delete the term "five percent beneficial owner" from Section 15 of H.R. 9323, 73d Cong., 2d Sess.,[5] demonstrate that the House was, in fact, acutely aware of the manipulative ability of large shareholders of corporations, recognizing that "a man who owns a large amount of stock, but nothing like a majority, controls the directors of the corporation," (78 Cong. Rec. 8037) and that "a great many large [stockholders * * * who are not officers * * * dictate the policies of the corporation." (78 Cong. Rec. 8038). The House view as to the manipulative ability of large shareholders was aptly summarized by Representative Rayburn, the sponsor of the legislation and Chairman of the Com-

[4] Gulf & Western has suggested (Br. 12) that even the Senate was confused in its discussion of Section 16(b) as an anti-manipulation provision, claiming that manipulative abuses were dealt with, not by Section 16(b), but by Sections 9 and 10 of the Act, 15 U.S.C. 78i and j. Section 9, however, is directed primarily toward manipulative practices in connection with the trading process itself. It does not deal with the manipulation of corporate financial policies as such. Moreover, the fact that the type of manipulative abuses covered in Section 16(b) is also subject to the proscriptions of Sections 9 and 10 "is neither unusual nor unfortunate." *Securities and Exchange Commission* v. *National Securities, Inc.*, 393 U.S. 453, 468.

[5] H.R. 9323, a substitute bill revising H.R. 8720, was passed by the House and, together with a considerably different version passed by the Senate, was referred to a committee of conference which reported out a conference bill that ultimately was enacted into law. Section 15 of H.R. 9323 did not contain a short-swing profit provision. It did, however, contain provisions for the reporting of transactions by insiders and for the prohibition of insider short sales, identical to Sections 16(a) and (c) of the Act, 15 U.S.C. 78p(a) and (c), except that the statutory ownership requirement in H.R. 9323 was 5 percent.

mittee that conducted hearings on both H.R. 7852 and H.R. 8720, as follows (78 Cong. Rec. 8038):

> A while ago we passed a provision relating to manipulation, one of the finest in the bill. In my opinion, we are now considering another very important antimanipulative section.
>
> * * * We * * * know * * * that in the case of any corporation having widely scattered stockholders the concentration of 5 or 10 or 20 or 30 percent of stock ownership is control; they can always get the proxies.
>
> * * * [What we have here] is a man, however, who says: "I do not want to be an officer or a director for the reason that if I accept such office I am held under this provision. I can, however, be the largest stockholder in the company and by proxy and otherwise dominate the officers, the directors, and the policies of the company * * *. I will not, therefore, allow myself to be elected an officer; I will not allow myself to be elected a director; but I will stay on the outside, I will control the company, I will manipulate its stock up and down. When it is the proper time to run the market up * * * I will run it up; when it is to my interest to run the market down I will have the power to run it down."
>
> * * * * *
>
> Mr. Chairman, I think it would be most unfortunate to let out the man who in the last analysis, in my opinion, really controls the corporation.

Finally, even if it were assumed that the House version of Section 16(b) in H.R. 8720 reflected a determination to exclude large shareholders from the statute's antimanipulative impact, Congress, contrary to Gulf & Western's assertion, enacted the Senate version of the statute.[6]

[6] Section 16(b) of S. 3420, unlike the corresponding provision in H.R. 8720, is identical to Section 16(b) of the conference bill that was passed by Congress, except that the conference bill contained a statute of limitations clause. *Compare* Section 16(b) of S. 3420 and Section 15(b) of H.R. 8720 *with* Section 16(b) of the conference bill set forth in H. Rep. No. 1838, 73d Cong., 2d Sess., pp. 16–17. Indeed, the conference report which accompanied the bill expressly states that the conferees incorporated the Senate version of the statute into the conference bill. H. Rep. No. 1838, 73d Cong., 2d Sess., pp. 35–36. See *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231, 237 (C.A. 2), certiorari denied, 320 U.S. 751.

CONCLUSION

For the foregoing reasons and for the reasons set forth in our main brief, the judgment of the court of appeals should be reversed in so far as it exonerates Emerson from liability under Section 16(b) for the profits realized upon its second sale of Dodge stock.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

SAMUEL HUNTINGTON,
Assistant to the Solictor General.

G. BRADFORD COOK,
General Counsel,

WALTER P. NORTH,
Associate General Counsel,

JACOB H. STILLMAN,
Assistant General Counsel,

FREDERIC T. SPINDEL,
Attorney,
Securities and Exchange Commission.

NOVEMBER 1971.

U.S. GOVERNMENT PRINTING OFFICE: 1971

In the Supreme Court of the United States

U.S.
1972
CLERK

OCTOBER TERM, 1971.

No. 70-79.

RELIANCE ELECTRIC COMPANY,
Petitioner,

v.

EMERSON ELECTRIC COMPANY,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT.

PETITION FOR REHEARING.

THOMAS P. MULLIGAN,
PATRICK J. AMER,
1750 Union Commerce Building,
Cleveland, Ohio 44115,

STEPHEN J. BURNS,
24701 Euclid Avenue,
Cleveland, Ohio 44117,

KENNETH S. TEASDALE,
611 Olive Street,
St. Louis, Missouri 63101,
Counsel for Petitioner.

Of Counsel:

JONES, DAY, COCKLEY & REAVIS,
ARMSTRONG, TEASDALE, KRAMER & VAUGHAN.

THE GATES LEGAL PUBLISHING CO., CLEVELAND, OHIO—TEL. (216) 621-5647

In the Supreme Court of the United States

OCTOBER TERM, 1971.

No. 70-79.

RELIANCE ELECTRIC COMPANY,
Petitioner,

v.

EMERSON ELECTRIC COMPANY,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT.

PETITION FOR REHEARING.

Reliance Electric Company, the petitioner herein, prays that the Court grant rehearing in this cause, decided by the Court on January 11, 1972.

REASONS FOR GRANTING REHEARING.

I.

The decisive consideration in the opinion of the Court in this case is as follows (Slip Opinion, p. 6):

> "But a 'plan' to sell that is conceived within six months of purchase clearly would not fall within § 16(b) if the sale were made after the six months had expired, and we see no basis in the statute for a different result where the 10% requirement is involved rather than the six months limitation."

There is a fundamental "basis in the statute" for a quite different result in these two cases. The distinction in Section 16(b) between purchases and sales which are separated by more than six months, and purchases and sales which are not, does not reflect an arbitrary congressional preference for semiannual periods. It reflects the well-founded congressional judgment that the opportunity for speculative manipulation by insiders diminishes sharply with the passage of time:

> "Congress recognized that the longer stock is held, the greater the likelihood that the market will react to factors unforeseen by the insider. Hence the certainty of profit varies inversely with the length of the period elapsing between initial purchase and subsequent sale of a security. And in fact congressional hearings revealed that abuses of inside information took place almost entirely in short-term speculation, especially in pool operation.[10] Consequently, Congress concluded that a thorough-going penalization limited to this short-term trading would prevent most of the abuse while at the same time allowing legitimate long-term investment by insiders." Note, "The Scope of 'Purchase and Sale' Under Section 16(b) of the Exchange Act," 59 *Yale L.J.* 510, 511 (1950).

[10] Sen. Rep. No. 792, 73d Cong., 2d Sess. 9 (1934).

The six-month limitation in Section 16(b) is based on the realities of securities markets. The insider who buys with a plan to sell *after* six months have passed has decided, by that very plan, to submit himself to the long-term investment risks to which every shareholder is subject. The legislative purpose of Section 16(b) is served, for Congress embodied in Section 16(b) its well-founded judgment that the insider who takes a long-term investment risk is probably not engaging in unfair use of insider information.

In contrast, the insider who sells via the two-step sales technique has *not* subjected himself to the investment risks of a six-month holding period. His plan is that he will *not* assume the risks to which the public shareholder is subject. He has acted as the speculator acts, taking the quick and "sure thing" profit, and the statute presumes he has used inside information unfairly in doing so. The legislative purpose, which is to prevent profit-taking on short-swing trading and thus to compel the insider to assume the same investment risks as the public shareholder, has not been served, and his profits should be taken from him. The form in which the insider carries out his disposition within six months is irrelevant to the congressional purpose.

The distinction, in short, is that he who decides to sell after six months have elapsed, and holds his stock for that period, must assume the risk of market fluctuations for a period which will in all likelihood dissipate the advantage of his insider position; he who plans to sell on the short swing and in two steps must assume only the task of finding two purchasers, which will not affect his insider advantage at all. The failure of the Court to make this distinction is a crucial misreading of the legislative purpose of Section 16(b), and should not be allowed to stand uncorrected.

II.

The opinion of the Court rests upon the conclusion, never expressly stated but necessary to the result, that the commercial and contract law of sales governs the definition of the word "sale" in Section 16(b). Thus the Court's opinion characterizes the holding of the District Court below as "a construction of the term 'at the time of sale' that treats two sales as one." Slip Opinion, p. 7. Nowhere,

however, does the Court address itself to the question whether in fact Emerson made two "sales" or one "sale" *as that term is used in Section 16(b)*. Nor does the Court address itself to the question whether Emerson's transactions were in substance one transaction, although in contractual form two, despite the fact that District Judge Regan based his holding upon this substance over form analysis.

The Court's position here cannot be reconciled with its decision in *SEC v. National Securities, Inc.*, 393 U.S. 453, 465-68 (1969). There the Court was presented with the question whether a particular transaction, clearly not a sale in contract or commercial law, constituted a "purchase or sale" under the definitions of those terms in Sections 3(a)(13) and 3(a)(14) of the Securities Exchange Act of 1934 and in the context of Section 10(b). After commenting on the breadth of the definitions themselves, the Court, through Mr. Justice Marshall, stated that the test of "purchase or sale" as those terms are used in the 1934 Act was "whether respondents' alleged conduct is the type of fraudulent behavior which was meant to be forbidden by the statute and the rule." 393 U.S. at 467. In the present case, the Court was presented with the question whether Emerson's transactions constituted a single "sale" under the definition of that term in the same Section 3(a)(14) of the Securities Exchange Act, in the context of Section 16(b). Departing from the rule of *National Securities*, the Court did *not* examine whether Emerson's conduct was the type of behavior meant to be forbidden by the statute; indeed, the Court *expressly declined to make this crucial determination*, stating that: *"If* a 'two-step' sale of a 10% owner's holdings within six months of purchase is thought to give rise to the kind of evil that Congress sought to correct through § 16(b),

those transactions can be more effectively deterred by an amendment to the statute . . . ." (Slip Opinion, p. 7; emphasis added.) If the Court intended here to overrule *National Securities,* that should be stated; if not, the distinction in principle, if any, should be explained. As it stands, *National Securities* is under a cloud of the Court's making.

For at least fourteen years, federal Courts of Appeal have applied under Section 16(b) the test of "purchase or sale" set forth in *National Securities:* ". . . whether a given transaction could possibly tend to accomplish the practices Section 16(b) was designed to prevent." *Blau v. Lamb,* 363 F.2d 507, 519 (2d Cir. 1966), *cert. denied,* 385 U.S. 1002 (1967). In opting for a "mechanical quality" in the statute, the Court has rejected the line of cases from *Ferraiolo v. Newman,* 259 F.2d 342 (6th Cir. 1958), *cert. denied,* 359 U.S. 927 (1959), through *Abrams v. Occidental Petroleum Corp.,* 450 F.2d 157 (2d Cir. 1971),[1] and has returned to the mechanistic and frequently-criticized view of *Park & Tilford, Inc. v. Schulte,* 160 F.2d 984 (2d Cir.), *cert. denied,* 332 U.S. 761 (1947).

The Court has wrongly failed to determine whether Emerson's transactions, *objectively defined,* present the possibility of speculative abuse and thus should be held to constitute a single "sale" in the context of Section

---

[1] In *Abrams v. Occidental Petroleum Corp., supra,* cited in petitioner's Reply Brief, the Second Circuit Court of Appeals held that an exchange of shares in one corporation for those of another pursuant to a merger agreement does *not* constitute a "sale" within the meaning of Section 16(b) where there was no possibility of speculative abuse, distinguishing *Newmark v. RKO General, Inc.,* 425 F.2d 348 (2d Cir.), *cert. denied,* 400 U.S. 854 (1970), where there was opportunity for speculative abuse. Footnote 2 of the Court's opinion is erroneous in that it fails to reflect what has been the position of the Second Circuit since a month prior to argument in this case.

16(b), whatever the commercial or contract law characterization of the transactions might be.[2]

When a 10% beneficial owner sells all his shares pursuant to a single contract within six months of their purchase, the possibility of unfair use of inside information is present. The possibility of abuse is not diminished one bit when the 10% beneficial owner sells his stock pursuant to two contracts rather than one. When the Court holds that the form in which the insider chooses to effectuate his disposition of stock determines the applicability of Section 16(b), the Court has subordinated the expressed intent of Congress, to prevent "the unfair use of information which may have been obtained . . ." to a judicially-created ideal of easy administration and mechanical applicability.[3]

---

[2] The Court rightly rejected the presence or absence of intent-to-avoid-Section 16(b)-liability as a test for imposition of liability. But the intent-which-determines-the-character-of-the transaction-itself is a different thing entirely. *Truncale v. Blumberg*, 80 F. Supp. 387, 391-92 (S.D.N.Y. 1948). Emerson intended, and in substance made, one disposition of stock, as the District Court found. Emerson's counsel's letter is only one evidence of the fact that a single disposition was intended. Further evidences that Emerson intended a single disposition were the facts that Emerson's first sale left Emerson with precisely 9.96% of Dodge's outstanding stock, and that Emerson's negotiations for its second sale commenced before its first sale was closed. The transactions, objectively defined, were one sale.

[3] The Court's opinion reflects a reluctance to impose Section 16(b) liability on the two-step sales technique because of uncertainty as to the rule which should govern future cases. Petitioner submits that uncertainty whether two sales within six months of a purchase should be irrebuttably presumed to be connected, as the SEC suggests, or rebuttably presumed connected, as the dissenting opinion suggests, is not a reason for refusing to impose liability in a case in which the trial court has found on the evidence that the two sales were connected as parts of a single disposition. In the event rehearing is granted, petitioner will brief in full the question of what rule will preserve the legislative purpose and at the same time provide guidance to the courts for relatively easy administration.

III.

In this case the Court has approved a technique whereby any 10% beneficial owner can now insulate from Section 16(b) a substantial portion of profits realized by him on short-swing purchases and sales. The two-step sales technique was not widely used in the past; this case is the first in which its lawfulness has been raised, and in none of the otherwise similar cases arising out of the 1967-68 tender offer period was the technique used.[4] Perhaps misled by a mistaken belief that the technique has been widely used, the Court did not appear to recognize in its opinion the fact that it was for the first time in the history of Section 16(b) giving judicial approval to a technique for profiting from inside information by short-term trading.

The financial community quickly recognized the novelty and the consequences of the Court's decision; the financial press recognized the Court's decision as a change in the direction of the law. The Wall Street Journal of January 12, 1972, headlined its article on the decision: "Supreme Court Opens Up Loophole in Trading by Corporation Insiders." Its lead paragraphs were as follows:

> "WASHINGTON—The Supreme Court opened a large loophole in the law Congress passed 38 years ago to prevent corporate insiders from speculating in their companies' securities.
>
> "The court's four-to-three decision, reflecting a new conservatism on business issues, will enable a large stockholder who engages in 'short-swing' transactions to avoid a major part of the liability that would have been incurred under the previous understanding of the law."

---

[4] See, *e.g.*, *Abrams v. Occidental Petroleum Corp.*, *supra*; *American Standard, Inc. v. Crane Co.*, ___ F. Supp. ____, CCH Fed. Sec. L. Rep. ¶ 93,237 (S.D.N.Y. 1971).

The New York Times of January 12, 1972, was equally alert to the implications of the Court's decision for the financial community:

> "WASHINGTON, Jan. 11—The Supreme Court ruled today that certain corporate 'insiders' can avoid some of the financial penalties for 'insider trading' if they sell the company's stock in two separate transactions instead of all at once."

Although it accurately reported the impact of the Court's decision, the financial press was in error in regarding it as a pro-business or conservative decision. It is not. It is a pro-speculator decision, a pro-raider decision, but not a pro-business decision. It is in the interest of every publicly-held business in this country to have the investing public assured that insiders cannot take advantage. The decision of the Court, which shows speculators how to plan their transactions and draft their contracts so as to take and keep short-swing profits, will be followed by clever insiders, and the confidence of the investing public will be eroded. The congressional purpose behind much of the Securities Exchange Act of 1934, which is to maintain investor confidence that securities markets are honest, will be impeded by this decision.

IV.

Petitioner submits that, in the opinion of the Court in this cause, the Court (1) did not make the important distinction between an insider who determines to sell after holding his purchased stock for six months, and the insider who determines to take an immediate short-term profit by adopting a particular technique for sale within six months; (2) did not decide whether Emerson's transactions afforded the possibility of abuse of inside information, and thus should be treated as one "sale" as the term is used in Section 16(b), departing from its own ruling in

National Securities, supra, in doing so; and (3) did not advert to the opportunities for unfair use of inside information which its decision would make available to all well-advised speculators. Since this is only the second case arising under Section 16(b) which this Court has heard in the history of the 1934 Act, the Court should not allow its January 11, 1972 opinion, which fails to deal with these crucial questions, to stand as the decision in this case.

This Petition for Rehearing should be granted, and the case set down for reargument.

Respectfully submitted,

THOMAS P. MULLIGAN,
PATRICK J. AMER,
1750 Union Commerce Building,
Cleveland, Ohio 44115,

STEPHEN J. BURNS,
24701 Euclid Avenue,
Cleveland, Ohio 44117,

KENNETH S. TEASDALE,
611 Olive Street,
St. Louis, Missouri 63101,
Counsel for Petitioner.

Of Counsel:
JONES, DAY, COCKLEY & REAVIS,
ARMSTRONG, TEASDALE, KRAMER & VAUGHAN.

CERTIFICATE OF COUNSEL

I certify that this petition is presented in good faith and not for delay.

PATRICK J. AMER

RELIANCE ELECTRIC CO. *v.* EMERSON ELECTRIC CO.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

No. 70–79. Argued November 10–11, 1971—
Decided January 11, 1972

Respondent, the owner of more than 10% of Dodge Mfg. Co.'s stock, within six months of the purchase thereof sold enough shares to a broker to reduce its holding to 9.96%, for the purpose of immunizing the disposal of the remainder from liability under § 16 (b) of the Securities Exchange Act of 1934. Under that provision a corporation may recover for itself the profits realized by an owner of more than 10% of its shares from a purchase and sale of its stock within any six-month period, provided the owner held more than 10% "both at the time of purchase and sale." *Held:* Under the terms of § 16 (b) respondent is not liable to petitioner (Dodge's successor) for profits derived from the sale of the 9.96% to Dodge within six months of purchase. Pp. 419–427.

434 F. 2d 918, affirmed.

STEWART, J., delivered the opinion of the Court, in which BURGER, C. J., and MARSHALL and BLACKMUN, JJ., joined. DOUGLAS, J., filed a dissenting opinion, in which BRENNAN and WHITE, JJ., joined, *post*, p. 427. POWELL and REHNQUIST, JJ., took no part in the consideration or decision of the case.

Thomas P. Mulligan argued the cause for petitioner. With him on the briefs were *Patrick J. Amer, Stephen J. Burns,* and *Kenneth S. Teasdale.*

Albert E. Jenner, Jr., argued the cause for respondent. With him on the brief were *Wesley G. Hall, R. H. McRoberts,* and *Thomas C. Walsh.*

Walter P. North argued the cause for the Securities and Exchange Commission as *amicus curiae.* With him on the briefs were *Solicitor General Griswold, Samuel Huntington, Philip A. Loomis, Jr.,* and *Jacob H. Stillman.*

Whitney North Seymour and *John A. Guzzetta* filed a brief for Gulf & Western Industries, Inc., as *amicus curiae.*

MR. JUSTICE STEWART delivered the opinion of the Court.

Section 16 (b) of the Securities Exchange Act of 1934, 48 Stat. 896, 15 U. S. C. § 78p (b), provides, among other things, that a corporation may recover for itself the profits realized by an owner of more than 10% of its shares from a purchase and sale of its stock within any six-month period, provided that the owner held more than 10% "both at the time of the purchase and sale." [1] In this case, the respondent, the owner of 13.2% of a corporation's shares, disposed of its entire holdings in two sales, both of them within six months of purchase. The

[1] Section 16 (b) provides:

"For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. . . . This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection." 15 U. S. C. § 78p (b).

The term "such beneficial owner" refers to one who owns "more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 12 of this title." Securities Exchange Act of 1934, § 16 (a), 15 U. S. C. § 78p (a).

first sale reduced the respondent's holdings to 9.96%, and the second disposed of the remainder. The question presented is whether the profits derived from the second sale are recoverable by the Corporation under § 16 (b). We hold that they are not.

I

On June 16, 1967, the respondent, Emerson Electric Co., acquired 13.2% of the outstanding common stock of Dodge Manufacturing Co., pursuant to a tender offer made in an unsuccessful attempt to take over Dodge. The purchase price for this stock was $63 per share. Shortly thereafter, the shareholders of Dodge approved a merger with the petitioner, Reliance Electric Co. Faced with the certain failure of any further attempt to take over Dodge, and with the prospect of being forced to exchange its Dodge shares for stock in the merged corporation in the near future,[2] Emerson, following a plan outlined by its general counsel, decided to dispose of enough shares to bring its holdings below 10%, in order to immunize the disposal of the remainder of its shares from liability under § 16 (b). Pursuant to counsel's recommendation, Emerson on August 28 sold 37,000 shares of Dodge common stock to a brokerage house at $68 per share. This sale reduced Emerson's holdings in Dodge to 9.96% of the outstanding common stock. The remaining shares were then sold to Dodge at $69 per share on September 11.

After a demand on it by Reliance for the profits realized on both sales, Emerson filed this action seeking a declaratory judgment as to its liability under § 16 (b). Emerson first claimed that it was not liable at all,

[2] The Court of Appeals for the Second Circuit has held that an exchange of shares in one corporation for those of another pursuant to a merger agreement constitutes a "sale" within the meaning of § 16 (b). *Newmark* v. *RKO General, Inc.*, 425 F. 2d 348, 354.

because it was not a 10% owner at the time of the *purchase* of the Dodge shares. The District Court disagreed, holding that a purchase of stock falls within § 16 (b) where the purchaser becomes a 10% owner by virtue of the purchase. The Court of Appeals affirmed this holding, and Emerson did not cross-petition for certiorari. Thus that question is not before us.

Emerson alternatively argued to the District Court that, assuming it was a 10% stockholder at the time of the purchase, it was liable only for the profits on the August 28 sale of 37,000 shares, because after that time it was no longer a 10% owner within the meaning of § 16 (b). After trial on the issue of liability alone, the District Court held Emerson liable for the entire amount of its profits. The court found that Emerson's sales of Dodge stock were "effected pursuant to a single predetermined plan of disposition with the overall intent and purpose of avoiding Section 16 (b) liability," and construed the term "time of . . . sale" to include "the entire period during which a series of related transactions take place pursuant to a plan by which a 10% beneficial owner disposes of his stock holdings" 306 F. Supp. 588, 592.

On an interlocutory appeal under 28 U. S. C. § 1292 (b), the Court of Appeals upheld the finding that Emerson "split" its sale of Dodge stock simply in order to avoid most of its potential liability under § 16 (b), but it held this fact irrelevant under the statute so long as the two sales are "not legally tied to each other and [are] made at different times to different buyers . . . ." 434 F. 2d 918, 926. Accordingly, the Court of Appeals reversed the District Court's judgment as to Emerson's liability for its profits on the September 11 sale, and remanded for a determination of the amount of Emerson's liability on the August 28 sale. Reliance filed a petition for certiorari, which we granted

in order to consider an unresolved question under an important federal statute. 401 U. S. 1008.

II

The history and purpose of § 16 (b) have been exhaustively reviewed by federal courts on several occasions since its enactment in 1934. See, *e. g., Smolowe* v. *Delendo Corp.*, 136 F. 2d 231; *Adler* v. *Klawans*, 267 F. 2d 840; *Blau* v. *Max Factor & Co.*, 342 F. 2d 304. Those courts have recognized that the only method Congress deemed effective to curb the evils of insider trading was a flat rule taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great. As one court observed:

> "In order to achieve its goals, Congress chose a relatively arbitrary rule capable of easy administration. The objective standard of Section 16 (b) imposes strict liability upon substantially all transactions occurring within the statutory time period, regardless of the intent of the insider or the existence of actual speculation. This approach maximized the ability of the rule to eradicate speculative abuses by reducing difficulties in proof. Such arbitrary and sweeping coverage was deemed necessary to insure the optimum prophylactic effect." *Bershad* v. *McDonough*, 428 F. 2d 693, 696.

Thus Congress did not reach every transaction in which an investor actually relies on inside information. A person avoids liability if he does not meet the statutory definition of an "insider," or if he sells more than six months after purchase. Liability cannot be imposed simply because the investor structured his transaction with the intent of avoiding liability under § 16 (b). The question is, rather, whether the method used to "avoid" liability is one permitted by the statute.

Among the "objective standards" contained in § 16 (b) is the requirement that a 10% owner be such "both at the time of the purchase and sale . . . of the security involved." Read literally, this language clearly contemplates that a statutory insider might sell enough shares to bring his holdings below 10%, and later—but still within six months—sell additional shares free from liability under the statute. Indeed, commentators on the securities laws have recommended this exact procedure for a 10% owner who, like Emerson, wishes to dispose of his holdings within six months of their purchase.[3]

Under the approach urged by Reliance, and adopted by the District Court, the apparent immunity of profits derived from Emerson's second sale is lost where the two sales, though independent in every other respect, are "interrelated parts of a single plan." 306 F. Supp., at 592. But a "plan" to sell that is conceived within six months of purchase clearly would not fall within § 16 (b) if the sale were made after the six months had expired, and we see no basis in the statute for a different result where the 10% requirement is involved rather than the six-month limitation.

The dissenting opinion, *post*, at 442, reasons that "the 10% rule is based upon a conclusive statutory presumption that ownership of this quantity of stock suffices to

[3] "[A] person who owns 15 percent and wants to sell down to 5 percent should sell 5-plus percent in one transaction and then, after he becomes a holder of slightly less than 10 percent, sell out the remainder." 2 L. Loss, Securities Regulation 1060 (2d ed. 1961).

"[T]he intention of the language was to exclude the second sale in a case where 10% is purchased, 5% sold within three months and the remaining 5% a month later. This latter construction of the Act is, it is believed, the only safe one to rely upon." Seligman, Problems Under the Securities Exchange Act, 21 Va. L Rev. 1, 20 (1934).

provide access to inside information," and that it thus "follows that all sales by a more-than-10% owner within the six-month period carry the presumption of a taint, even if a prior transaction within the period has reduced the beneficial ownership to 10% or below." While there may be logic in this position, it was clearly rejected as a basis for liability when Congress included the proviso that a 10% owner must be such both at the time of the purchase and of the sale. Although the legislative history affords no explanation of the purpose of the proviso, it may be that Congress regarded one with a long-term investment of more than 10% as more likely to have access to inside information than one who moves in and out of the 10% category. But whatever the rationale of the proviso, it cannot be disregarded simply on the ground that it may be inconsistent with our assessment of the "wholesome purpose" of the Act.

To be sure, where alternative constructions of the terms of § 16 (b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders.[4] But a construction of the term "at the time

[4] See, *e. g.*, *Adler* v. *Klawans*, 267 F. 2d 840 (one who is a director at the time of sale need not also have been a director at the time of purchase). In interpreting the terms "purchase" and "sale," courts have properly asked whether the particular type of transaction involved is one that gives rise to speculative abuse. See, *e. g.*, *Bershad* v. *McDonough*, 428 F. 2d 693 (granting of an option to purchase constitutes a "sale"). And in deciding whether an investor is an "officer" or "director" within the meaning of § 16 (b), courts have allowed proof that the investor performed the functions of an officer or director even though not formally denominated as such. *Colby* v. *Klune*, 178 F. 2d 872, 873; cf. *Feder* v. *Martin Marietta Corp.*, 406 F. 2d 260, 262–263. The various tests employed in these cases are used to determine whether a transaction, objectively defined, falls within or without the terms of the statute. In no case is liability predicated upon "considerations of intent, lack of motive, or improper conduct" that are irrelevant in § 16 (b) suits. *Blau* v. *Oppenheim*, 250 F. Supp. 881, 887.

of . . . sale" that treats two sales as one upon proof of a pre-existing intent by the seller is scarcely in harmony with the congressional design of predicating liability upon an "objective measure of proof." *Smolowe* v. *Delendo Corp., supra,* at 235. Were we to adopt the approach urged by Reliance, we could be sure that investors would not in the future provide such convenient proof of their intent as Emerson did in this case. If a "two-step" sale of a 10% owner's holdings within six months of purchase is thought to give rise to the kind of evil that Congress sought to correct through § 16 (b), those transactions can be more effectively deterred by an amendment to the statute that preserves its mechanical quality than by a judicial search for the will-o'-the-wisp of an investor's "intent" in each litigated case.

III

The Securities and Exchange Commission, participating as *amicus curiae,* argues for an interpretation of the statute that both covers Emerson's transaction and preserves the mechanical quality of the statute. Seizing upon a fragment of legislative history—a brief exchange between one of the principal authors of the bill and two members of the Senate Committee during hearings on the bill [5]—the Commission suggests that the sole pur-

[5] That exchange was as follows:

"Senator CAREY. Suppose this stock passed to an estate, and the estate had to raise money?

"Mr. CORCORAN. I do not think, in that case, sir, the statute would apply.

"Senator KEAN. Why not?

"Senator CAREY. The estate is the beneficiary.

"Mr. CORCORAN. I do not believe it would. Certainly the intention was that it should not apply to that sort of a situation." Hearings on Stock Exchange Practices before the Senate Committee on Banking and Currency pursuant to S. Res. 84, 56, and 97, 73d Cong., 1st and 2d Sess., pt. 15, p. 6558. It was sometime after this exchange that the bill was revised to add the exemptive provision.

pose of the requirement of 10% ownership at the time of both purchase and sale was to exclude from the statute's coverage those persons who became 10% shareholders "involuntarily," as, for example, by legal succession or by a reduction in the total number of outstanding shares of the corporation. The effect of such an interpretation would be to bring within § 16 (b) all sales within six months by one who has gained the position of a 10% owner through voluntary purchase, regardless of the amount of his holdings at the time of the sale. We cannot accept such a construction of the Act.

In the first place, we note that the SEC's own rules undercut such an interpretation. Recognizing the interrelatedness of § 16 (a) and § 16 (b) of the Act, the Commission has used its power to grant exemptions under § 16 (b) to exclude from liability any transaction that does not fall within the reporting requirements of § 16 (a).[6] A 10% owner is required by that section to report at the end of each month any changes in his holdings in the corporation during that month. The Commission has interpreted this provision to require a report only if the stockholder held more than 10% of the corporation's shares at some time during the month.[7] Thus, a 10% owner who, like Emerson, sells down to 9.96% one month and disposes of the remainder the following month, would presumably be exempt from the reporting requirement and hence from § 16 (b) under the SEC's own rules, without regard to whether he acquired the stock "voluntarily."

But the SEC's argument would fail even if it were not contradicted by the Commission's own previous construction of the Act. As we said in *Blau* v. *Lehman;*

[6] SEC Rule 16a–10, 17 CFR § 240.16a–10.

[7] Form 4, Securities Exchange Act Release No. 6487 (March 9, 1961).

368 U. S. 403, 411, one "may agree that . . . the Commission present[s] persuasive policy arguments that the Act should be broadened . . . to prevent 'the unfair use of information' more effectively than can be accomplished by leaving the Act so as to require forfeiture of profits only by those specifically designated by Congress to suffer those losses." But we are not free to adopt a construction that not only strains, but flatly contradicts, the words of the statute.

The judgment is

Affirmed.

MR. JUSTICE POWELL and MR. JUSTICE REHNQUIST took no part in the consideration or decision of this case.

MR. JUSTICE DOUGLAS, with whom MR. JUSTICE BRENNAN and MR. JUSTICE WHITE concur, dissenting.

On June 16, 1967, Emerson Electric Co., in an attempt to wrest control from the incumbent management, acquired more than 10% of the outstanding common stock of Dodge Manufacturing Co. Dodge successfully resisted the take-over bid by means of a defensive merger with petitioner, Reliance Electric Co. Emerson then sold the shares it had accumulated, within six months of their purchase, for a profit exceeding $900,000.

Because this sale purportedly comprised two "independent" transactions, the first of which reduced Emerson's holdings to 9.96% of the outstanding Dodge common, the Court today holds that the profit from the second transaction is beyond the contemplation of § 16 (b) of the Securities Exchange Act.[1] So Emerson

[1] 15 U. S. C. § 78p (b):

"For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any

need not account to the corporation for these gains. In my view, this result is a mutilation of the Act, contrary to its broad remedial purpose, inconsistent with the flexibility required in the interpretation of securities legislation, and not required by the language of the statute itself.

I

Section 16 (b) is a "prophylactic" rule, *Blau* v. *Lehman*, 368 U. S. 403, 413, whose wholesome purpose is to control the insiders whose access to confidential information gives them unfair advantage in the trading of their corporation's securities.[2]

---

period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

[2] "Next comes the everlasting problem of protecting the fellow on the outside from the insider . . . . That is, the problem of protecting the stockholder—and every fellow who buys into the market is a stockholder—who does not know as much about the company as the fellow on the inside. . . . [T]he poor little fellow does not know what he is getting into, and it is just as important in preventing unwarranted and destructive speculation, to have the fellow on the outside protected from the fellow on the inside who is an officer or director of the corporation or a pool with inside information, as

The congressional investigations which led to the enactment of the Securities Exchange Act unearthed convincing evidence that disregard by corporate insiders of their fiduciary positions was widespread and pervasive.[3] Indeed,

> "the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities,"

---

it is not to let the little fellow buy too much stock by setting the margins too low." Hearings on H. R. 7852 and H. R. 8720 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess., 85 (1934) (testimony of Thomas Corcoran).

[3] One particularly glaring example concerned two brothers whose ownership of a little over 10% of a company's stock gave them a controlling interest. Just before the company voted to omit a dividend, the brothers disposed of their holdings for about $16,000,000. When news of the dividend became public a short time later, they repurchased an equivalent amount of stock for about $7,000,000, showing a profit of some $9,000,000 on the short-swing deal. S. Rep. No. 792, 73d Cong., 2d Sess., 9 (1934).

Much of the insider abuse involved participation in so-called "pools," which were dummy accounts in a corporation's stock established to buy and sell, at the same time, and at a frenetic pace. By so churning the account, it was often possible to engineer a false impression of immense activity in the stock, and to arrange spectacular, but artificial, price rises. One pool bought and sold almost 1,500,000 shares of RCA stock in a single seven-day period in 1929, at a net profit to its members of almost $5,000,000. S. Rep. No. 1455, 73d Cong., 2d Sess., 32–33, 47 (1934). Another famous pool involved the stock of the American Commercial Alcohol Company. During the summer of 1933, eight insiders and their associates reaped a profit of $300,000 on an investment of $62,000. A third pool, in the stock of the Fox Film Corporation, made $2,000,000 in five months. This pool was notable for the extent to which large stockholders participated. *Id.*, at 55–68. During 1929, over 100 stocks listed on the New York Stock Exchange were subjects of pools. *Id.*, at 32. Insider participation in these pools was ubiquitous. See generally F. Pecora, Wall Street Under Oath (1939).

was reported by the Senate subcommittee charged with the investigation to be "[a]mong the most vicious practices unearthed at the hearings." S. Rep. No. 1455, 73d Cong., 2d Sess., 55 (1934). The subcommittee did not limit its attack to directors and officers.

> "Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others." *Ibid.*

Despite its flagrantly inequitable character, the most respected pillars of the business and financial communities considered windfall profits from "sure-thing" speculation in their own company's stock to be one of the usual emoluments of their position. Cook & Feldman, Insider Trading Under the Securities Exchange Act, 66 Harv. L. Rev. 385, 386 (1953); 10 SEC Ann. Rep. 50 (1944). These abuses were perpetrated by such ostensibly reliable men and institutions as Richard Whitney, President of the New York Stock Exchange,[4] Albert H. Wiggin and the Chase National Bank of which he was the chief executive officer,[5] and Charles E. Mitchell and the National City Bank of which he was Chairman of the Board.[6]

Section 16 (b) was drafted to combat these "predatory operations," S. Rep. No. 1455, *supra*, at 68, by removing all possibility of profit from those short-swing insider trades occurring within the statutory period of six

---

[4] See SEC, Report on Investigation in the Matter of Richard Whitney Pursuant to Section 21 (a) of the Securities Exchange Act of 1934 (Nov. 1, 1938).

[5] See Pecora, *supra*, n. 3, at 131–188.

[6] *Id.*, at 70–130.

months.[7] The statute is written broadly, and the liability it imposes is strict. Profits are forfeit without proof of an insider's intent to gain from inside information, and without proof that the insider was even privy to such information.[8] *Feder* v. *Martin Marietta Corp.*, 406 F. 2d 260, 262 (CA2).

II

Today, however, in the guise of an "objective" approach, the Court undermines the statute. By the simple expedient of dividing what would ordinarily be a single transaction into two parts—both of which could be performed on the same day, so far as it appears from the Court's opinion—a more-than-10% owner may reap windfall profits on 10% of his corporation's outstanding stock. This result, " 'plainly at variance with the policy of the legislation as a whole,' " *United States* v. *American*

---

[7] The six-month period is, as Mr. Corcoran said during the hearings on the bill, a "crude rule of thumb," Hearings on Stock Exchange Practices before the Senate Committee on Banking and Currency pursuant to S. Res. 84, 56, and 97, 73d Cong., 1st and 2d Sess., pt. 15, p. 6557. It represents a balance struck between the need to deter short-swings based on inside information and a desire to avoid unduly inhibiting long-term corporate investment. S. Rep. No. 792, 73d Cong., 2d Sess., 6. Six months was hit upon, presumably, on the view that "where the insider is obliged to hold the original security . . . for longer than six months . . . market fluctuations are likely to wipe out his profits." Comment, 117 U. Pa. L. Rev. 1034, 1054 (1969).

[8] "This approach maximized the ability of the rule to eradicate speculative abuses by reducing difficulties in proof. Such arbitrary and sweeping coverage was deemed necessary to insure the optimum prophylactic effect." *Bershad* v. *McDonough*, 428 F. 2d 693, 696 (CA7).

It is somewhat anomalous that the majority relies on a feature of the statutory scheme designed to broaden its scope in order to insulate from the operation of the statute a device by which the goals of the statute can be largely frustrated.

Trucking Assns., 310 U. S. 534, 543, is said to be required because Emerson, owning only 9.96%, was not a "beneficial owner" of more than 10% within the meaning of § 16 (b) "at the time of" the disposition of this block of Dodge stock.

If § 16 (b) is to have the "optimum prophylactic effect" which its architects intended, insiders must not be permitted so easily to circumvent its broad mandate. We should hold that there was only one sale—a plan of distribution conceived "at the time" Emerson owned 13.2% of the Dodge stock, and implemented within six months of a matching purchase. Moreover, in the spirit of the Act we should presume that *any* such "split-sale" by a more-than-10% owner was part of a single plan of disposition for purposes of § 16 (b) liability.

This construction of "the sequence of relevant transactions," *Bershad* v. *McDonough*, 428 F. 2d 693, 697 (CA7), is not foreclosed by any language in the statute. The statutory definitions of such terms as "purchase," "sale," "beneficial owner," "insider," and "at the time of" are not, as one might infer from the Court's opinion, objectively defined words with precise meanings.

> " 'Whatever the terms "purchase" and "sale" may mean in other contexts,' they should be construed in a manner which will effectuate the purposes of the specific section of the [Exchange] Act in which they are used. SEC v. National Securities, Inc., 393 U. S. 453, 467." *Id.*, at 696.

MR. JUSTICE STEWART, while on the Court of Appeals, explained the manner appropriate for the construction of the statutory definitions in the context of § 16 (b):

> "Every transaction which can reasonably be defined as a purchase will be so defined, if the transaction is of a kind which can possibly lend itself to the speculation encompassed by Section 16 (b)." *Ferraiolo* v. *Newman*, 259 F. 2d 342, 345 (CA6).

Applying this salutary approach toward the statutory definitions, the courts have reasoned that, because of the opportunities for abuse inhering in his position, a director must account both for purchases made shortly before his appointment, *Adler* v. *Klawans*, 267 F. 2d 840 (CA2), and for sales made shortly after his resignation, *Feder* v. *Martin Marietta Corp.*, *supra*. "Options," which played such a large role in the manipulative practices disclosed during the 1930's,[9] are not ordinarily thought to be "purchases" or "sales" of the underlying commodity; yet, because of the opportunity for abuse inherent in the device, courts have held that an option can be a "sale," when granted, within the meaning of § 16 (b). *Bershad* v. *McDonough*, *supra*. But, in order to bring the underlying transaction within the six-month limitations of § 16 (b), an option was also held to be a "purchase" when exercised. *Booth* v. *Varian Associates*, 334 F. 2d 1 (CA1). Similarly, where there was an opportunity for the abuse of inside information, a conversion of debentures into common stock was held to be a "sale"; *Park & Tilford* v. *Schulte*, 160 F. 2d 984 (CA2); but where there was no such opportunity, a similar conversion was held not to be. *Blau* v. *Lamb*, 363 F. 2d 507 (CA2).

The common thread running through the decisions is that whether we approach the problem of this case as a question of "beneficial ownership" at the time of the second transaction, or as a question whether the two transactions were one "sale," it "is not in any event primarily a semantic one, but must be resolved in the light of the legislative purpose—to curb short swing speculation by insiders." *Ferraiolo* v. *Newman*, *supra*, at 344.

Until today, the federal courts have been almost universally faithful to this philosophy, "even departing where necessary from the literal statutory language."

[9] See Twentieth Century Fund, Stock Market Control 114–118 (1934).

Feder v. *Martin Marietta Corp., supra,* at 262. Thus, a tender offer, although it may justifiably be described as a series of discrete purchases, has been treated as a single purchase. *Abrams* v. *Occidental Petroleum,* 323 F. Supp. 570, 579 (SDNY), rev'd on other grounds, 450 F. 2d 157 (CA2). And, in order to prevent a construction of the statute whereby

> "it would be possible for a person to purchase a large block of stock, sell it out until his ownership was reduced to less than 10%, and then repeat the process, ad infinitum,"

the phrase "at the time of the purchase and sale," on which the Court places such heavy reliance, was defined to mean "simultaneously with" purchase, and "just prior to" sale. *Stella* v. *Graham-Paige Motors,* 104 F. Supp. 957, 959 (SDNY). As one commentator noted, this holding

> "necessitates a logical inconsistency insofar as the phrase 'at the time of purchase and sale' is treated as meaning the moment after purchase and the moment before sale." Recent Developments, 57 Col. L. Rev. 287, 289.

Yet, as in the present case, "the discrepancy seems slight in view of the broader statutory policies involved." *Ibid.*

Thus, should the broadly remedial statutory purpose of § 16 (b) require it, the literal language of the statute would not preclude an analysis in which the two transactions herein at issue are treated as part of a single "sale."

III

The potential for abuse of inside information in the present case is self-evident. Equally obvious is the fact

that the modern-day insider is no less prone than his counterpart of a generation ago to succumb to the lure of insider trading where windfall profits are in the offing. Indeed, in a survey of "reputable" businessmen, 42% of those responding indicated they would themselves trade on inside information, and 61% believed that the "average" executive would do likewise.[10] Thus, it would appear both that § 16 (b) was directed at such conduct as is herein at issue and that the protection § 16 (b) affords is as necessary today as it was when the statute was enacted.

Despite the fact that the decision below strikes at the vitals of the statute, the Court says it must be affirmed because to treat "two sales as one upon proof of a pre-existing intent by the seller" detracts from the "mechanical quality" of the statute and is "scarcely in harmony with the congressional design of predicating liability upon an 'objective measure of proof.'" *Ante,* at 425.

This "mechanical quality," however, is illusory.

> "There is no rule so 'objective' ('automatic' would be a better word) that it does not require some mental effort in applying it on the part of the person or persons entrusted by law with its application." *Blau* v. *Lamb, supra,* at 520.

Thus, the deterrent value of § 16 (b) depends not so

---

[10] Baumhart, How Ethical Are Businessmen?, Harv. Bus. Rev., July-Aug. 1961, p. 6, at 16. The survey had posed the following hypothetical:

"What would you do if . . . as a director of a large corporation, you learned at a board meeting of an impending merger with a smaller company? Suppose this company has had an unprofitable year, and its stock is selling at a price so low that you are certain it will rise when news of the merger becomes public knowledge." *Id.,* at 7.

much on its vaunted "objectivity" as on its "thoroughgoing" qualities.

> "We must suppose that the statute was intended to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or stockholder and the faithful performance of his duty." *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231, 239 (CA2).

Insiders have come to recognize that "in order not to defeat [§ 16 (b)'s] avowed objective," federal courts will resolve "all doubts and ambiguities against insiders." *Blau* v. *Oppenheim*, 250 F. Supp. 881, 884–885.

Moreover, courts have not shirked this responsibility simply because, as here, such a resolution may require a factual inquiry. In *Blau* v. *Lehman*, *supra*, this Court said that on an appropriate factual showing, an investment banking firm might be forced to disgorge profits made from short-swing trades in the stock of a corporation on whose board a partner of the firm was "deputized" to sit. *Id.*, at 410. In *Colby* v. *Klune*, 178 F. 2d 872 (CA2), cited by the majority, the court permitted a factual inquiry into the possibility that an individual might be a "de facto" officer or director, although not formally labeled as such. Virtually all courts faced with § 16 (b) problems now inquire into the opportunity for abuse inherent in a particular type of transaction, in order to see if applying the statute would serve its purposes. See, *e. g.*, *Bershad* v. *McDonough*, *supra*; *Blau* v. *Max Factor & Co.*, 342 F. 2d 304 (CA9); *Booth* v. *Varian Associates*, *supra*; *Ferraiolo* v. *Newman*, *supra*. And, even under the narrow approach of the majority, I presume it would still be open, in cases like this one, to inquire whether the ostensibly separate sales are "legally

tied." [11] It follows that the necessity of a factual inquiry is no bar to the application of the statute to the present case.

It is beyond question, of course, that a prime concern of the statute was that a requirement of positive proof of an insider's "intent" would render the statute ineffective. Insofar as the District Court's approach appears to place the burden on the plaintiff to demonstrate the existence of a "plan of distribution," it is justifiably open to criticism. The broad sweep of § 16 (b) requires that a minimal burden be placed on putative plaintiffs.

But this goal—elimination of proof problems—is subsidiary to the statute's main aim—curbing insider speculation. Whatever "mechanical quality" the statute possesses, it was intended to ease the plaintiff's burden, not to insulate the insider's profits.

Thus, we should not conclude, as does the majority, that there is no *enforceable* way to combat the potential

---

[11] Such an inquiry might well be extensive. The following commentary, aimed at the Court of Appeals decision below, applies with equal force to the majority's approach:

"Even if the statute could be construed as allowing an exception for a severed sale of the final 9.9 percent of stock otherwise within section 16 (b), when are sales to be found separate and independent? The *Emerson* decision provides no guidelines. All it says is: 'The factual question as to whether a particular sale is a separate and independent sale is a matter for decision under the peculiar facts of the particular case. In this regard each case must stand or fall on its own fact.' What facts? What of separate sales to the same vendee? How separate must the parties be—different companies, different corporations, different entities? Must there be an interval beween the sales? How long? If *Emerson* is to be followed, would the question be not so much how discreet the sales are as how discreet counsel has been? The inquiry seems to lead away from the legislative intent that all potential violators be held to the full sanctions of section 16 (b)." Recent Decisions, 5 Ga. L. Rev. 584, 590 (footnote omitted).

for sharp practices which inheres in the "split-sale" scheme.

> "[T]he 'objective' or 'rule of thumb' approach need not compel a court to wink at the substantial effects of a transaction which is rife with potential sharp practices in order to preserve the easy application of the short-swing provisions under Section 16 (b). Certainly the interest of simple application of the prohibitions of Section 16 (b) does not carry so far as to facilitate evasion of that provision's function by formalistic devices." *Bershad* v. *McDonough*, *supra*, at 697 n. 5.

A series of sales, spaced close together, are more than likely part of a single plan of disposition. Plain common sense would indicate that Emerson's conduct in the present case had probably been planned, even if there were no confirmation in the form of an admission. It is statistically probable that any series of sales made by a beneficial owner of more than 10%, within six months, in which he disposes of a major part of his holdings, would be similarly connected.

We, therefore, should construe the statute as allowing a rebuttable presumption that any such series of dispositive transactions will be deemed to be part of a single plan of disposition, and will be treated as a single "sale" for the purposes of § 16 (b).[12] Because the burden

---

[12] Such a presumption is not a novel suggestion in the interpretation of securities legislation. The Securities Act of 1933, 48 Stat. 74, as amended, 15 U. S. C. § 77a *et seq.*, for example, requires that public securities offerings be registered with the SEC. § 5, 15 U. S. C. § 77e. But registration is not required of stock sold in a so-called "private placement." § 4 (2), 15 U. S. C. § 77d (2). The purchaser of such stock, however, cannot avoid the registration requirements when he resells it unless his original purchase was not made "with a view to . . . distribution." § 2 (11), 15 U. S. C. § 77b (11). The difficulties inherent in determining this elusive "view," see 1 L. Loss,

would be on the defendant, not the plaintiff, such a rule would operate with virtually the same less-than-perfectly automatic efficiency that the statute now does, and it would comport far more closely with the statute's broad, remedial sweep than does the approach taken by the Court.

Such a rule would not, moreover, import questions of "intent" into the statutory scheme. Any factual inquiry would involve only an objective analysis of the circumstances of the various dispositions in the series, applying the "various tests" established by the cases "to determine whether a transaction, objectively defined, falls within or without the terms of the statute." *Ante*, at 424 n. 4.

Securities Regulation 665–687 (2d ed. 1961), have prompted the suggestion that there be a rebuttable presumption that a sale made within two years of purchase indicates the original purchase was made with a view to distribution. 4 *id.*, at 2652 (Supplement to 2d ed. 1969); see also The Wheat Report, Disclosure to Investors 165 (CCH 1969).

A similar rebuttable presumption applies in the case of a "controlling person" (as defined in Rule 405, 17 CFR § 230.405 (f)). Such a person need not register his sales under the 1933 Act if in any six-month period they amount to no more than 1% of the issuer's outstanding stock. Rule 154, 17 CFR § 230.154. But, "if a plan exists to effect a series of sales during successive 6 months' periods, such sales cannot be considered in the category of routine trades but must be deemed a distribution not exempted by the rule." Securities Act Release No. 4818, 31 Fed. Reg. 2545 (1966).

Different policies, of course, underlie the 1933 and 1934 Acts. Yet, the above-described provisions of the 1933 Act, like § 16 (b) in the 1934 Act, are aimed at deterring certain transactions because of their inherent opportunities for abuse. The 1933 Act presumptions are based on a judgment that a short-term series of sales is statistically likely to reflect an "intent" to engage in a public distribution without registration. The presumption I would apply in the case of § 16 (b) is justified by a similar statistical likelihood that a series of dispositive transactions, like Emerson's, undertaken within six months of a matching purchase, was pursuant to a "plan of disposition."

Only if a beneficial owner carried an affirmative burden of proof—that his series of dispositive transactions were not of a type that afforded him an opportunity for speculative abuse of his position as an insider—should we say that he was not such a beneficial owner "at the time of . . . . sale." [13]

IV

The Court suggests two additional factors militating against Emerson's liability under § 16 (b). First, the Court implies that it is contrary to the SEC's own rules. This argument rests on the power given to the SEC by § 16 (b) to exempt from its scope those transactions that are "not comprehended within the purpose" of the section. Pursuant to this authority, the SEC has promulgated Rule 16a–10, providing that transactions not required to be reported under § 16 (a) are exempt from § 16 (b) as well.

The SEC's reporting requirements are contained in "Form 4." Until recently, this Form required insiders—officers, directors, and more-than-10% owners—only to report transactions occurring in a calendar month in which they met the formal requirements to be denominated such an insider. Emerson sold down to 9.96% in August, then sold out in September. Presumably, it did not have to report the September sale on Form 4, and thus, by operation of Rule 16a–10, the September sale is argued to be exempt from the operations of § 16 (b) as well.

---

[13] It is conceded that Emerson could not meet such a burden in the present case. In general, an insider could perhaps defeat the presumption of a plan by showing "changed circumstances" similar to those required to avoid registration requirements under the private offering exemption of the 1933 Act. See 1 Loss, Securities Regulation, *supra*, at 665–673; 4 *id.*, at 2646–2654 (1969).

Inasmuch as the SEC's power to promulgate such a rule is not "a matter solely within the expertise of the SEC and therefore beyond the scope of judicial review," *Greene* v. *Dietz*, 247 F. 2d 689, 692 (CA2), this argument loses substantially all its force after *Feder* v. *Martin Marietta Corp.*, *supra*. There, the court held, in the face of the identical argument that Rule 16a–10 was invalid, insofar as it operated through Form 4 to exempt transactions by ex-directors from liability under § 16 (b). The court reasoned that the limitation of the reporting requirement to the calendar month in which a transaction occurred was "an arbitary . . . [and] unnecessary loophole in the effective operation of the statutory scheme," *id.*, at 269, because it required reporting of some transactions 30 days after an ex-director's resignation, but insulated others taking place the very next day.

Form 4 did, however, extend § 16 (b) liability to at least some transactions occurring after resignation.

> "Therefore, inasmuch as Form 4, a valid exercise of the SEC's power, has already extended § 16 (b) to cover, in part, an ex-director's activities, a less arbitrarily defined reporting requirement for ex-directors is but a logical extension of § 16 (b) coverage, would be a coverage in line with the congressional aims, and would afford greater assurance that the lawmakers' intent will be effectuated." *Ibid.*[14]

This analysis is equally applicable to the reporting requirements of ex-10% owners.

---

[14] In response to the *Feder* case, the SEC amended its rules to require disclosure of all transactions by directors and officers within six months prior to their appointment and for six months after their resignations. Rule 16a–1, 17 CFR § 240.16a–1 (d), (e) (as amended, Sept. 30, 1969). Thus, the restrictive reporting requirements relied upon by the majority apply only to beneficial owners, itself an arbitrary distinction.

Second, the Court analogizes Emerson's "plan" to a sale "conceived" during the six-month period but not made until after the expiration of the statutory limitation. The Court incorrectly assumes that such a sale could not fall within § 16 (b). If the "conception" were sufficiently concrete to be construed as a "contract to sell," or an "option," there would indeed be liability. Cf. *Bershad* v. *McDonough, supra.* In any event, the analogy fails because the purposes of the six-month rule are different from the purpose of the 10% rule.

The six-month limitation is based on Congress' estimation that beyond this time period, normal market fluctuations sufficiently deter attempts to trade on inside information. *Blau* v. *Max Factor & Co., supra,* at 308. Thus, it is consistent with the statutory scheme to permit an insider to "plan" a sale within the six-month period that will not take place until six months have passed from a matching purchase.

But the 10% rule is based upon a conclusive statutory presumption that ownership of this quantity of stock suffices to provide access to inside information. *Newmark* v. *RKO General, Inc.,* 425 F. 2d 348 (CA2). The rationale of the six-month rule implies that such information will be presumed to be useful during that length of time. It follows that all sales by a more-than-10% owner within the six-month period carry the presumption of a taint, even if a prior transaction within the period has reduced the beneficial ownership to 10% or below.

V

In sum, neither the statutory language nor the purposes articulated by the majority justify the result reached today. Rather than deprive § 16 (b) of vitality in the course of a vain search for a nonexistent purity of operation, we should reverse the judgment of the Court of Appeals and remand the case for further proceedings.